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Riyadh renaissance

Saudi Arabia sets out its vision to overcome dependence on oil

Volatility hedging
Blockchain trials
Predictive analytics
Securities finance consultants
Next generation technology

NUMBER 283

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INTERNATIONAL SECURITIES FINANCE

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Brexit boost for emerging market hedge funds 26 July 2016

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Executive recrimination

Board-level pay is back on the agenda for shareholders, says *Ceri Jones*

Shareholders have opposed executive pay packages this year at dozens of major firms including Anglo American, Deutsche Bank, Shire, Ladbrokes and Reckitt Benckiser.

The spring revolt against escalating director pay comes at a time when real wages have been squeezed for nine consecutive years, according to data from the UK's Trade Union Congress. FTSE 100 CEOs earned an average £5m in 2014, according to the High Pay Centre, which means they take home more in two days than the average worker does in a year.

Nonetheless, it was a surprise when Theresa May, in her successful bid to become UK prime minister, pledged tighter controls on executive pay with greater employee representation on boards, a cap on pay ratios and for annual shareholder votes on pay to be binding. This could be a game-changer.

Even under the existing regime, introduced in 2013, quoted companies are obliged to hold legally-binding votes on pay policies every three years. Almost all shareholder revolts to date have been advisory and powerless to change remuneration packages – but this may well change when the first round of binding votes takes place.

Employment contracts

Only engineering group Weir has so far lost a binding vote, which forced it to abandon a share option scheme. At 72%, this was also the biggest vote against a pay package this year, well ahead of 59% opposing a £13.9m deal for BP boss Bob Dudley and 53% opposing bonuses at medical firm Smith & Nephew. Unsurprisingly, shareholders seem more likely to vote if the vote actually counts.

Business bosses are alarmed about binding votes as they claim they would cut across employment contracts and provoke litigation from executives forced to surrender existing elements. "This would present legal difficulties, and practical issues such as developing a new remuneration package every year. In addition, there would be much more work for shareholders such as fund managers to monitor," argues Oliver Parry, director of corporate governance at the Institute of Directors.

The political tide has turned, echoing across the developed world. Israel recently passed a law capping pay in the financial system at ILS2.5m ($650,000) a year. In June, Switzerland held a referendum on whether to curtail pay at state-owned enterprises. Neither US presidential candidate thinks he or she can win in November without executive pay on the agenda.

Shareholders are still relatively reluctant to get involved and there is typically more interest where shareholders are looking for a change of strategy. Only 30% of WPP shareholders recently voted against Sir Martin Sorrell's £70m pay deal, mindful that the share price has doubled in five years.

In the US, Steve Silberstein has been taking BlackRock to task for voting in favour of pay packages in 97% of cases, as well as CEO Larry Fink's $26m pay packet. While Silberstein's own fortune deflects accusations of sour grapes, even after an impassioned half-hour speech at BlackRock's AGM only 4% supported him.

By contrast, fund manager Neil Woodford is pushing GlaxoSmithKline to split off its HIV, consumer healthcare and dermatology divisions from its core medicines and vaccines arm as well as to install an external candidate when CEO Sir Andrew Witty steps down next March.

While Sir Andrew can't reasonably be held responsible for a slump triggered by generic competition for its Advair asthma drug, Woodford has criticised him for diversifying into low-margin consumer healthcare goods such as nicotine patches. Ironically, the share price has recently recovered relative to the S&P pharmaceuticals index, boosted by a robust performance from Viiv and positive margin progression.

Stepping up the scrutiny on director pay should lead to closer examination of the 60-80% that is tied to performance and paid in complex leadership equity acquisition plans, bonus deferral and share-based schemes. Often, the hurdles are too low and directors are simply being rewarded for doing their jobs. Raise the bar, however, and performance bonuses are castigated for short-termism.

Retrospective teeth could be the only answer. "If a company has underperformed in the previous year, then the grant should be scaled back. Where, for example, safety is a primary concern the bonuses for the director who takes responsibility should also be correlated and scaled back," says Neville White, head of SRI policy & research, at EdenTree Investment Management.

Better together?

Consolidation in the asset management industry now seems inevitable but may have to wait until the terms of Brexit are clear, says *Cherry Reynard*

The UK active management sector is under sustained attack. There is ongoing pressure on fees – smart beta and passive management continue to encroach on its traditional client base – while regulatory hurdles and shifts in technology have made it more challenging and expensive to run a business. And this is all before the implications of Brexit are considered. This should make the sector ripe for consolidation, but deals so far this year have been piecemeal.

Most agree that M&A activity should happen and the necessary drivers are in place. "There is a need for active management to consolidate in light of the growth of passive," says Gary Potter, co-head of F&C multi-manager solutions at BMO Global Asset Management. "Equally, the banks will be looking for ways to enhance their bottom line growth, in a way that they can't do in basic banking. They can raise debt cheaply and could well go and buy asset management businesses."

Mounting pressure on fees is forcing asset managers to find new and more efficient ways of operating. Flows into passive vehicles reveal the scale of the challenges faced by the asset management sector – recent figures from Morningstar showed that investment into passive funds has been four times larger than into active ones since 2007. There is widespread recognition that in a lower growth world, fees have become a more important consideration.

This should, in itself, drive M&A activity but Deloitte showed in its *2016 Financial Services M&A Predictions* research that asset managers can achieve scale relatively quickly. If greater assets under management (AuM) does not necessarily bring greater economies of scale a primary reason for activity is removed.

The most recent asset management deals have tended to be more strategic, characterised by investment houses buying expertise in individual areas. For example, Schroders acquired Brookfield Investment Management's securitised products investment management team, GAM acquired European equities specialist Taube Hodson Stonex and Aberdeen acquired Advance Emerging Capital.

Brexit boost

Undoubtedly, the Brexit referendum result has created real problems for the UK sector. It threatens passporting, a problem for fund management groups with significant international businesses. Fund flows had dried up anyway, particularly in certain areas such as UK equities; UK-domiciled funds saw £38bn in outflows over the year to 31 May, according to figures from Thomson Reuters Lipper.

> "A lot of UK-owned enterprises now look very cheap for those buying in dollars or euros"
> TOM MACDONALD, DELOITTE

Tom MacDonald, head of banking transaction services at Deloitte, says there have been almost no M&A transactions cancelled, though some have been postponed. "Brexit has had little effect on M&A volumes overall. That said, activity had been a little supressed in the run-up to Brexit, so volumes are relatively stable at these lower levels."

The most notable deal to go to the wall has been the Pioneer (the management arm of UniCredit) and Santander Asset Management deal. Talks had started in November 2014 to merge the two asset management businesses but fell apart in July 2016. While the collapse in negotiations was mostly due to regulatory hurdles, Brexit sealed its fate.

For the whole sector, much will depend on the final outcome of the Brexit negotiations. "If you are a UK fund manager selling to UK investors, there isn't a great deal of change," says MacDonald. "But if you are a multi-national, your business could be more challenged. If we stay in the EEA, if we go for a Norway-style deal, there will be no change to market access. It will be painful, but manageable. But if we are fully out, it will be difficult."

MacDonald believes that the depreciation of sterling may draw foreign buyers. "A lot of UK-owned enterprises now look very cheap for those buying in dollars or euros. Then again, they would need to feel there will be a bounce in the currency." Within the fund management sector, this could create interest around some of the listed groups.

There is a scenario in which even a hard Brexit (leaving the EEA) could drive further corporate activity. UK asset managers will need a foothold within the EU for distribution. While many international companies already have a business in Dublin or Luxembourg, it could see some groups making acquisitions.

Certainly, some fund groups still appear to be comfortable talking about acquisitions post-Brexit. Most recently, Phil Wagstaff, global head of distribution at Henderson, said that the group was still looking at making acquisitions within the next five years.

Building on performance

Fund-of-funds flows have suffered due to the pervasive focus on fees but investors are returning where the structure adds most value, says *Paul Golden*

After four years of decline, net UK retail sales of funds-of-funds rose last year. Managers will hope that their mantra of product transparency and accessibility will continue to outweigh investor concerns over effectively paying two layers of fees.

Investment Association data shows that net retail sales for funds-of-funds in 2015 were £3.7bn, up from £3.1bn in 2014. Fund-of-funds assets represented 12.6% of total fund industry assets under management (AuM) at the end of last year, but a recent Fundscape report indicates that they punched well above their weight, securing 52% of industry sales in the first half of 2015.

While Jupiter and Schroders account for around a quarter of the UK market, Fundscape notes that the leading players by sales last year were 7IM, which has solutions that are popular with both advisers and retail investors (particularly its passive-based funds), and Hargreaves Lansdown, due to its captive distribution channel and effective marketing techniques.

According to spokesperson Danny Cox, Hargreaves Lansdown multi-managers are popular because they have a long and stable track record of outperforming their peers. "Funds-of-funds are broadly 0.5% more expensive than a basket of funds bought individually, so investors have to ask whether they believe they will get value for that additional cost. Compared to discretionary management services, 0.5% is very competitive."

"In practice, unfettered funds do not appear to bring a meaningful enhancement to a multi-asset portfolio's risk-return profile"
RANDAL GOLDSMITH, MORNINGSTAR

Multi-asset funds

Funds-of-funds fees have generally not come down any more than those of directly invested multi-asset funds. This is to be expected, as they have a second layer of fees to pay on the funds they invest in, observes Randal Goldsmith, senior analyst manager research at Morningstar.

When asked whether the fund-of-funds structure offers additional value to multi-asset funds, Goldsmith notes that in theory unfettered multi-manager funds (ones that can invest in external managers) have the flexibility to structure a portfolio selecting the best managers within each sector and asset class and to bring an added dimension of diversification by style.

Daniel Lockyer, senior fund manager Hawksmoor Investment Management, says it is unusual for a single fund management house to perform well across all asset classes, so the unfettered approach allows the firm to select the best fund manager for each asset class, geographic region or investment style.

Investor Association data also reveals managers' increased confidence in internal funds. Almost one third of net retail sales were invested internally last year, compared to less than a quarter in 2014 and 26% in 2013.

"In practice, unfettered funds do not appear to bring a meaningful enhancement to a multi-asset portfolio's risk-return profile and the selection of managers who repeat past outperformance sufficiently to overcome the second layer of charges is something many fund-of-funds managers fail to achieve," adds Goldsmith.

Lockyer adds: "We believe there is a place for in-house funds for smaller-sized portfolios where it is more cost effective than a bespoke portfolio – provided the client agrees to this."

A well-managed, unfettered fund-of-funds that is run to a clear risk mandate and designed to meet client expectations can offer all the diversification of a model portfolio without any of the administrative inefficiencies of CGT, rebalancing, switching or delayed buy/sell decisions, according to Dan Russell, managing director of Verbatim Asset Management.

"This has been demonstrated recently by the post-Brexit suspension of property funds," he says. "Many funds-of-funds have been able to weather this storm with little impact compared to the administrative hassle faced by firms implementing a model portfolio."

According to Russell, the majority of research suggests that clients of financial advisers who purchase ongoing advice are not concerned about the mechanics of underlying solutions. "The decision around fettered versus unfettered is most likely made by the advisory firm at the point they design and build their client proposition and investment process. There is no right or wrong solution – just the extent to which they believe that further diversification beyond fettered funds is appropriate for their clients."

Fundscape predicts that external funds-of-funds will outperform internal ones over the next five years. Assuming weak economic conditions, its expectation is that external fund assets will grow at an average compound rate of 14% in the five years to 2020 compared with 11% for in-house funds.

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Smooth operators

Volatility-based products have attracted investors in their droves but evidence suggests that they are overpaying for safety, writes *Cherry Raynard*

Spooked by macroeconomic uncertainty, the past five years have seen investors find increasingly inventive ways to avoid equity market volatility. From the advent of absolute return funds, through to minimum variance, low volatility or VIX-related exchange-traded funds, strategies that seek to minimise the ebb and flow of stock market pricing have found resonance.

The first quarter of 2016, for example, saw record inflows into risk-based ETFs such as minimum volatility. Lyxor ETF research found that the sector attracted €1.2bn ($1.35bn) of the €2bn that flowed into smart beta ETFs over the quarter. This has persisted into the second quarter, with minimum volatility strategies seeing inflows of €399m in May, the highest ever in a single month.

The absolute return sector has also been consistently strong. It was the best-selling Investment Management Association (IMA) sector in May and the second best selling in June, as investors sought lower volatility options in the run-up to Brexit. Equally, ETFs based on volatility indices, such as the VIX (based on the implied volatility in the S&P 500 index) and the VSTOXX indices (based on the implied volatility in the EURO STOXX 50) have been brought to market in Europe and have proved popular with investors.

Institutional investors particularly are increasingly operating with either an implicit risk budget or explicit risk target. Risk-targeted funds in particular have become increasingly popular in the wake of regulatory change and investor suitability requirements. For these managers, targeting lower volatility equity options gives them a higher risk budget to spend elsewhere. At a time when investors are increasingly been pushed up the risk scale by central bank policy, having volatility budget to spare while retaining access to stock market growth has proved attractive.

Absolute return funds

The investment industry's first response to the clamour for lower volatility products was absolute return funds. Many of these aimed to target equity market-like returns with around half the volatility, by harnessing pure alpha. There is still considerable debate on whether these funds have achieved their goals.

In general – and the sector is diverse – many have been better at avoiding volatility than generating real returns. Within the IMA Targeted Absolute Return sector only 8 out of 75 funds have a volatility higher than 10, according to Financial Express data. There is only one fund out of 240 in the IMA Global Equity sector with volatility below 10.

However, this has come at the expense of returns. The five-year average return for the absolute return sector is just 16.6%, while that of the global equity sector is 77.4%. While this is perhaps an unfair comparison, given the unusual strength of equity markets over the past five years, it does raise the question of whether the pursuit of low volatility is compromising long-term returns in the sector.

Indeed, funds in the absolute return sector are up just 0.7% year-to-date. In spite of all the volatility since the start of the year, investors would have generated returns of 17.4% in the average global equity fund.

The ETF option is a relatively new choice for managing volatility, but has proved a more successful option. "There

> **"Minimum variance strategies have been very successful, but I would point to rising valuation multiples"**
> CHARLES ARAM, RESEARCH AFFILIATES

are two broad classes of product," says Chris Riley, investment research manager at RSMR. "One type builds a portfolio of those stocks that have had the lowest volatility in the past. It is based on that simple process – that what has worked in the past will continue to show lower volatility in the future." He adds that the returns from these products have been relatively good and a lot of capital has flowed into that area.

"The second main type of product is rarer. For these the provider looks to structure a portfolio of the lowest volatility stocks, but to take the correlation of stocks into account. This means not just buying stocks with the lowest correlation, but may include some higher volatility stocks that have good correlation properties with other stocks to bring the overall volatility of a portfolio down."

Within the first option, there is a range of approaches. A number of new participants have entered the market so the choice for investors is broad. Significant players in the sector include iShares, Lyxor and Ossium. Some simply take the index and over or under-weight stocks according to their historic volatility. There are ETFs covering most of the major indices. Others will operate a fully unconstrained option, excluding or shorting higher volatility stocks. Riley says that shorting higher volatility stocks has been more powerful for returns in back-testing, though it may introduce other risks.

Returns have been good because many of the lowest volatility stocks have been popular with investors over recent years. Stable businesses, with stable revenue and cash flow have been highly prized. But this may also suggest a future problem for minimum or low volatility ETFs.

Charles Aram, head of EMEA at Research Affiliates, says: "If you overpay, no matter what the quality of the asset, you will get a poor investment result. Minimum variance strategies have been very successful, but I would point to rising valuation multiples. In 2002, low volatility stocks had a valuation multiple considerably lower than the wider market. It is now somewhat higher. In other words, the stocks in these strategies are now much more expensive than the general market. The worry is that while these strategies might still deliver low volatility, you can't expect high returns. Valuation does matter."

"Investors need, to some extent, to accept that volatility is what gives you the returns"
GARY POTTER, BMO GAM

Value of volatility

The VIX indices also have their limitations. In theory, investors should receive protection against volatility, because their investment rises as volatility rises. However, VIX ETFs don't hold the actual VIX, which is simply a calculation, but instead track futures on the VIX index. While they do this accurately, VIX futures are not a perfect proxy.

Equally, it should be said, volatility is not that high relative to historical levels so these strategies haven't made a great deal of money. The path of the VIX index shows that volatility now is around a quarter of the level seen at the height of the financial crisis. At its peak at the end of 2008, the index level reached 80. Even at the height of the market panic at the start of this year, the index only hit 26.

It is a similar picture in European markets. This also peaked out in October 2008 (at 71) and has never subsequently reached similar heights. The closest it came was in September 2011, but this year it hasn't got above 40 and is down 21.62% over the past 52 weeks (STOXX to 12 August).

There is perhaps a more fundamental question: should investors really be avoiding volatility? Are investors paying too a high price to protect against volatility that isn't really that high and should anyway be part and parcel of investing?

"What is driving an investor to avoid volatility?" questions Gary Potter, co-head of F&C multi-manager solutions at BMO Global Asset Management. "Is it because they are scared of risk? Is this off-benchmark risk? The key is really to have enough time to embrace risk. Investors need, to some extent, to accept that volatility is what gives you the returns. There is a perception that avoiding volatility is somehow a good thing. I would point out that there are only three areas that have struggled for the year to date and one of them is absolute return."

Certainly, a distinction should be made between long and short-term volatility. Avoiding volatility at all costs, and over the very short term, has proved a poor strategy for investors over the past five years. The best strategy has been to retain market exposure but focus on stocks with historically low volatility but, going forward, this approach has inherent dangers as this type of stock trades at high valuations. Investors may find that minimising volatility comes at an increasingly elevated cost.

ASSET MANAGEMENT: APPOINTMENTS

Standard Life Investments has announced two additions to its ESG investment team with the hire of **Marc Brammer** and **Sophie Rahm** as responsible investment analysts. The pair will play important roles in Standard Life's ongoing efforts to integrate responsible investment considerations with the wider investment process Brammer joins from Inflection Point Capital Management while Rahm joins the team from her previous role as a ESG analyst for Schroders.

Helena Morrissey is stepping down as chief executive of **Newton Investment Management**. Morrissey, one of the most influential women in the City of London, will be succeeded by Hanneke Smits. Smits was previously chief investment officer of $27bn private equity firm Adams Street Partners and a member of the firm's executive committee. Newton Investment Management, a BNY Mellon subsidiary, was voted equities manager of the year in *Global Investor/ISF*'s annual awards.

Kames Capital has appointed **Robin Black** as an investment manager in the firm's Edinburgh-based equities team. Black will support the global equity mandate team, with particular focus on Japan, and will report to head of equities, Stephen Adams. He joins from investment banking and financial services group Macquarie where he worked as a managing director covering global sales of Pan Asian equities in the firm's Hong Kong office.

Royal London Asset Management (RLAM) has expanded its global high yield team with four new appointments ahead of the launch of a multi asset credit fund. The appointments, consisting of a fund manager, a senior credit analyst, and two assistant credit analysts, are intended to support RLAM's Multi Asset Credit Fund, which will be a globally diversified portfolio focused on alternative credit and aimed at institutional investors. **Khuram Sharih** joins from Newton Asset Management. He will be joined by **Sebastien Poulin**, **Gary Ewen** and **Tom Elliott**.

Margaret Frost

Margaret Frost is to become the new head of **Allianz Global Investor's** UK institutional business. The move follows Allianz GI's recent acquisition of global fixed income specialist Rogge Global Partners. Frost had worked at Rogge since 2010, most recently as a senior portfolio manager. She will start her new position in October and report to Irshaad Ahmad, the head of European institutional at Allianz GI. The division invests billions on behalf of UK pension schemes and insurers.

AXA Investment Managers has appointed **John King** to its UK equities desk as an assistant portfolio manager in an effort to strengthen the team. King, based in London, will support the seven strong UK equities team, which is led by George Luckraft, Head of UK equities at AXA IM. He joins the team from Jefferies where he was a senior vice president for the UK equity sales team, and has spent the last six years in UK equities, working at N+1 Singer and UBS as well as a five year stretch at Ernst & Young.

EdenTree Investment Management has strengthened its global equity capabilities with the appointment of **David Osfield**. Working alongside chief investment officer Robin Hepworth, Osfield will co-manage the group's EdenTree Amity International Fund. Osfield, who joined EdenTree in July 2016, began his career at Alliance Trust in 2002 and has held a range of responsibilities across global equity portfolios over his 14-year career.

Deloitte has expanded its Irish investment management team with the appointment of **Matthew Foley** to partner. Foley specialises in the provision of assurance and advisory services to clients in the investment management and insurance sectors. He has extensive experience in audit, accounting, advisory and regulatory services, garnered from working with both Irish domiciled companies as well as large multinational financial services groups. In a statement, Foley said he plans to help clients with a huge range of issues such as increased regulation, the impact of audit reform, and of course strategic challenges arising from Brexit.

T Rowe Price has added Matthew Jenkins to its UK intermediary team. Jenkins, who has been appointed to the newly-created position of head of strategic partners, extends the firm's reach into the advisory and platform market as the group looks set to unveil its OEIC fund range in the coming months. Jenkins will spearhead T Rowe Price's relationships with platforms, life companies, fund ratings agencies and large national advisory firms.

TIAA Global Asset Management has appointed of **Brian Nick** as chief investment strategist for TIAA Investments. Based in New York, Nick will work closely with the investment management team to analyse market data, identify trends and provide insights on events driving market activity. Nick will share his perspectives on global market trends, equities and fixed income markets outlook, and other investment analysis, through presentations to individual and institutional investors.

PIMCO has appointed **Emmanuel (Manny) Roman** as the investment management firm's next chief executive officer. Current CEO Douglas Hodge will assume a new role as managing director and senior adviser when Roman joins PIMCO in November. Roman has nearly 30 years of experience in the investment industry, with expertise in fixed income and proven executive leadership, most recently as CEO of Man Group, one of the world's largest publicly-traded alternative asset managers and leader in liquid, high-alpha investment strategies.

Trading places

Exchanges are increasingly looking beyond straightforward mergers with their peers and are set to venture deep into sell-side territory. *Andrew Neil* reports

When exchanges want to reduce their operating costs and diversify their revenue streams their first response is often to seek a merger with another exchange. However, by no means all such mergers ultimately pay off and other options are available.

"We expect exchanges will continue to consolidate, with the announced merger between the London Stock Exchange and Deutsche Börse simply being the latest in a long line," said Octavio Marenzi, founder and chief executive of consultancy Opimas. "While the logic underpinning these mergers appears to be watertight, migrating to a combined platform can be fraught with difficulties."

A handful of exchange mergers in the past have failed to live up to expectations as they dealt imperfectly with the technical and organisational difficulties of integrating their operations. Defensive acquisitions to retain market share also often lead to incumbents, frequently slow to adapt, making costly acquisitions in order to avoid running the risk of obsolescence. This was true of Nasdaq's acquisition of Inet, and NYSE's acquisition of Archipelago.

Vertical integration

A recent report from Opimas suggested bourses should consider more creative strategies, which involve moving aggressively into areas occupied by banks and securities firms.

"In most industries, business strategies aimed at moving up and down the value chain are considered absolutely normal. However, vertical integration of exchanges has not come naturally," explains Paris-based Marenzi, who previously worked at Celent and Oliver Wyman. "They have been extremely reluctant to trespass on sell-side firms' territory and offer products and services that might compete with them."

This hesitancy, he says, is understandable given that sell-side firms are exchanges' core customers and there are risks in offending them. However, this deference has deeper roots. Exchanges will have to overcome their traditional deference to the sell-side – a legacy of the ownership structure when they were created – if they are to prosper, according to Marenzi.

"The current generation of senior exchange managers came of age in a market where banks and securities firms were not only the virtually exclusive users of the trading platforms, but actually owned the exchanges."

Few member-owned exchanges remain. Those that were once operated on a semi-profitable basis for the benefit of the banks and broker-dealers that owned them are long gone.

Marenzi says a reluctance to alienate former members persists. Unfortunately for exchanges, the favour is not being returned. "Broker-dealers are constantly creating alternatives to exchanges in an attempt to reduce their dependence on them and shrink the fees that exchanges can charge.

"In the future we expect the boundaries between the sell side and exchanges to blur more and more, with exchanges increasingly performing functions that have historically been reserved for broker-dealers."

For example, smart order routing, already provided by exchanges for US equities, is likely to become more common for derivatives exchanges. The same is true for European and Asian equities.

"There is no reason that exchanges should not offer more sophisticated orders, including algorithmic trading strategies," he adds. "Programmed trades would be much easier for users to execute on an exchange than at a broker-dealer. Furthermore, exchanges could easily handle orders facilitating pairs trading, where one stock is sold at the same time as another is bought, without help from the sell side.

> **"We expect the boundaries between the sell side and exchanges to blur more and more"**
> OCTAVIO MARENZI, OPIMAS

Exchanges could also move into multi-asset trading strategies, combining, for example, FX trades with foreign equities with rising numbers of exchange mergers spanning asset classes. Marenzi also anticipates that exchanges will expand their less cyclical subscription-based services such as market data and push into territories currently occupied by sell-side firms and interdealer brokers.

Total revenues for exchanges globally are growing and expected to exceed $20bn in 2016. Marenzi expects exchanges will continue to flourish and form one of the few bright spots in capital markets. Profit margins for exchanges remain remarkably high with an average of approximately 60% for leading exchanges, according to Opimas.

However, it won't be plain sailing for exchanges to hold onto their pricing power. "The sell side is experimenting with cheaper alternatives to trading," Marenzi adds. "Leaner upstarts could take market share, and European regulators have ruled that fees for the fast-growing business of providing market data must be 'reasonable'."

"To diversify their product lines, exchanges must increasingly position themselves as alternatives to sell-side institutions. That is an uncomfortable activity for them, but considerable revenues are at stake."

Digital detectives

Predictive analytics is increasingly being used by asset managers to identify suspicious behaviour, finds *Paul Golden*

Asset managers have much to gain from applying business intelligence processes – and specifically more sophisticated analysis of data – to their compliance regime.

To effectively comply with new regulatory initiatives, asset managers are restructuring enterprise-wide data architecture and systems to increase data, reporting and record-keeping capabilities, including near-real time reporting, according to the EY report *Winning the global regulation game*.

Predictive analytics is being used to enhance business intelligence capabilities, explains Rob Toguri, UK data and analytics leader at the professional services firm. "One powerful application is more comprehensive trade surveillance to detect and prevent market abuse and fraud by merging trade data with other data sources."

Firms are introducing analytical models and reporting dashboards to address a range of key compliance risks, for example performing automated analyses of key client documentation to automatically identify specific requirements. "Asset managers are also introducing more sophisticated visualisations such as consistent inputs to their regulatory reporting and internal reports, to more efficiently and effectively ensure the required quality level across these aggregated datasets," says Toguri.

Business intelligence enables asset managers to better interrogate their positions and investment decisions and, if used well, can show in advance how compliance and regulatory requirements are affected by these decisions, or by market movements or other changing factors, adds Steve Young, managing partner at Citisoft.

"Technology can play a huge part in highlighting practices that could create regulatory issues within an organisation before they come to the attention of regulators," he says. "It is already a significant element of the management of regulatory issues, but as firms gain greater expertise and experience with these tools this can only improve and extend."

Vincent Kilcoyne, capital markets industry lead SAS UK & Ireland, observes that compliance with regulations such as MiFID and anti-money laundering requires asset managers to effectively manage vast amounts of data from trading systems, internal spreadsheets, emails, chat and voice communication. "To identify any irregularities in their processes, asset managers need to be able to monitor for suspicious activity and ensure due diligence on customers."

Kilcoyne suggests managers should start by analysing customer activity and risk characteristics. "By grouping segments of customers or accounts together based on inherent characteristics – for example, average transactional volume or net worth – asset managers can easily identify customers who are expected to behave in a similar fashion to other customers but don't and risk-rank each alert based on a variety of factors, from the number of past alerts to the possibility that the alert will result in a regulatory filing."

"Technology can play a huge part in highlighting practices that could create regulatory issues within an organisation before they come to the attention of regulators"

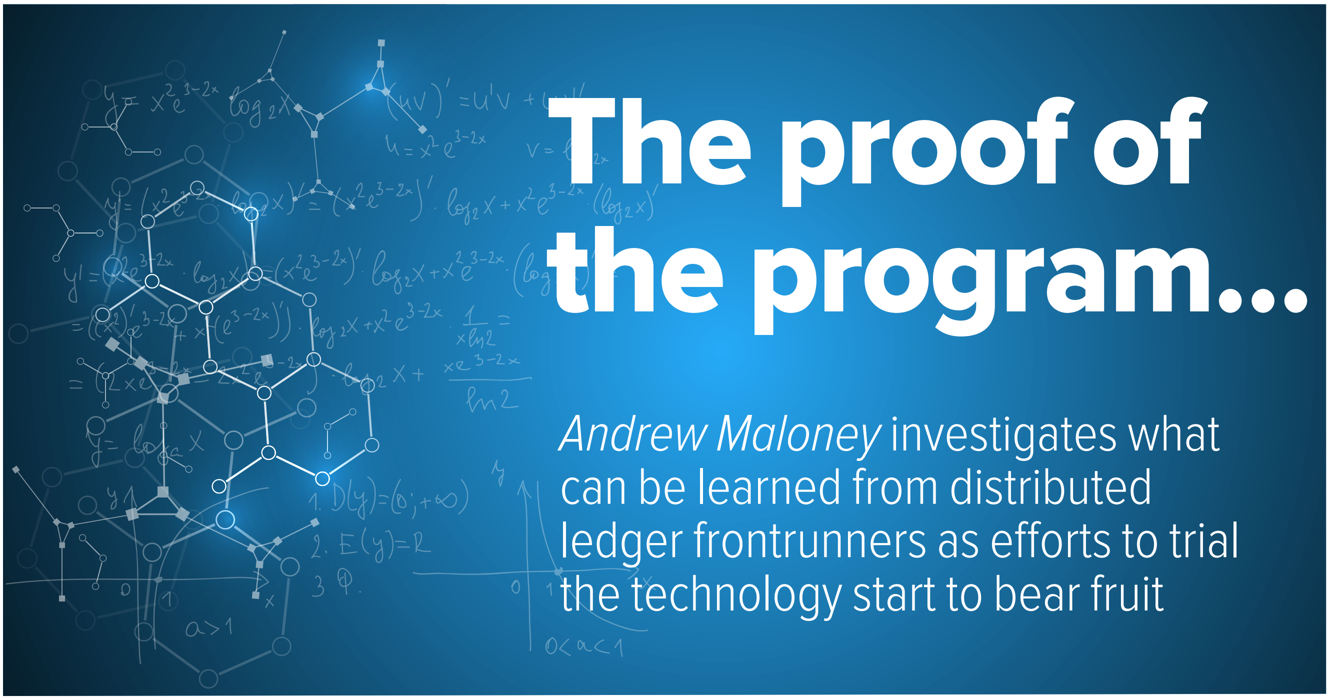
Unstructured data

The transformation and analysis work that is being doing on data ahead of representing it as a report or visualisation is particularly significant, suggests Lexalytics CEO Jeff Catlin. "One area seeing significant advancement in capabilities is the analysis of unstructured data (emails, social media posts, images) and correlating it with structured data such as phone logs and trade activity. Legacy text analytic systems have been programmed to find certain key words related to how someone might violate regulations, but those do not take into account changing language and some of the differences in medium, author, message or context."

If a manager has a centralised system monitoring communications that is constantly kept up to date, it can flag when someone is starting to go down a path that is not going to end well, he adds. "Sometimes people make mistakes or aren't aware of a change in the laws. By capturing information in an automated, consistent fashion, they can be retrained early before a misunderstanding becomes a regulatory problem."

The challenge for most asset managers is to take advantage of the opportunities available while budgets and margins are under pressure from competing investment demands, says Toguri.

In the future, it is likely that asset managers will increasingly use technology to help reduce their operational risks relating to regulatory issues, he concludes. "They will utilise and merge big data from new sources such as systems process logs, voice and email and will overlay this with powerful machine learning and cognitive techniques, which will help them better understand behaviours across business processes."



The proof of the program...

Andrew Maloney investigates what can be learned from distributed ledger frontrunners as efforts to trial the technology start to bear fruit

As distributed ledger technology matures, interest has turned from the general to the specific. Conversations have moved on from asking what blockchain-based technologies merely are to the specific benefits for their individual usage case and how it can be practically implemented.

Blockchain consortiums looking to inject node-based ledger efficiency into the financial system are becoming ever more common. Groups such as the R3 consortium, involving 45 financial companies, are gaining members constantly as the market begins to take notice of the potential offered by a distributed ledger.

Less financially-focused projects have also gained traction over the last year, with HyperLedger, a cross-industry initiative designed to provide a standardised and modular distributed ledger framework to ensure easy interoperability between various industries, swelling to more than 60 members.

However, the timeline for the launch of products is not short and many remain pre-proof of concept. Areas of significant throughput and those that require standardisation between participants, such as clearing and settlement, will see longer development cycles as they require intense cooperation in the design phase and so are better served through consortiums. Conversely, faster maturity cycles will be the norm in use cases that are entirely in-house or exist between limited numbers of participants.

Processes such as financial invoicing and know-your-customer (KYC) records are more likely to see rapid adoption as they do not require widespread use in order to function. These technologies are already being researched and developed by numerous entities, and provide the most concrete details on possible implementation.

Post-trade

While blockchain technology has the potential to dramatically alter post-trade services, "for this to happen, the technology has to be re-imagined and redesigned from the ground up so that its attributes are specifically matched to the particular needs of the post-trade sector," says Thorsten Peisl, CEO of RISE Financial Technologies.

Blockchain implementation is not as simple as ripping the core out of the Bitcoin system and cramming it into a fundamentally different use case. Bitcoin, which represents the most obvious and widely-tested distributed ledger architecture, includes a publically accessible transaction record that would be unsuitable for use by financial entities.

Companies that are working on distributed ledger systems must find and fill these holes in Bitcoin's blueprint, while also adapting the technology to better suit its particular markets.

RISE, working on distributed ledger technology for post-trade settlement and securities safekeeping, has already had to overcome some of these challenges in the development of its products. While its blockchain-based system retains the immutable ledger format which provides a permanent audit trail, it does so based on a permissioned solution, offering a public record of which asset has been moved and between which counterparties but withholding further information from users without a private key.

In a split access system, asset owners can gain access to the details of how their assets are traded and by whom, while brokers are able to access to data from just their clients. This permissioned system simultaneously allows full accountability with an incontrovertible audit trail, alongside the privacy required by financial institutions.

In the Bitcoin environment, data verification is handled by private Bitcoin miners that verify the contents of each block for a monetary, which increases the money supply. In a system that is not permissioned, these incentives are necessary to encourage verification, while barriers to entry such as the cryptographic puzzles used in Bitcoin are necessary to disincentivise false verifications.

RISE relies instead on approved and regulated market participants such as CSDs, CCPs and custodians to enter data correctly, with an indisputable data trail guarding against falsified entries. Because these entities are already regulated and trusted by the community, a less resource-intensive but still consensus-based verification system can be used.

On the other hand, Blockchain implementation in the post-trade space benefits from the already fairly standardised formats used; negating many of the issues involved in other markets where the widespread use of legacy system complicates the automatic entry of data. RISE has found that as long as it offers SWIFT compatibility, and a robust application programming interface (API) allowing users to integrate the technology into their data terminals, integration with individual systems is less of an issue.

In the system it is currently testing RISE settles no transactions (all settlement occurs off ledger), which frees the company from the responsibility and cost such a capability would bring. Instead, trading venues still deal with submitting the transaction details and the system sends the resulting data out to its network of regulated entities for verification and approval. Once the settlement instruction is verified it is added to the next update as 'settled'.

In a de-central settlement solution the transaction validation process can offer numerous benefits according to Peisl. First, it can help to enforce compliance with certain regulations, check availability and eligibility of assets, or whether trading counterparts are qualified entities for the respective transaction.

Secondly, utilising a consensus mechanism, the nodal consensus-based architecture can guarantee that two simultaneous orders for the same securities are resolved without both being approved, ensuring that only a single competing transaction is recorded.

Thirdly, this system layout could offer regulators the option to view all recorded trade data, and the possibility of encoding regulatory rules in the validation process, guaranteeing compliance.

> "The technology has to be re-imagined and re-designed from the ground up so that its attributes are specifically matched to the particular needs of the post-trade sector"
> THORSTEN PEISL, CEO OF RISE FINANCIAL TECHNOLOGIES

Clearing & settlement

The Australian Securities Exchange has been vocal about looking to blockchain for a replacement for its clearing and settlement system CHESS. In its recent 2016 results presentation, the company announced that it has completed the initial phase of a working distributed ledger solution for a subset of use cases, and` that work on the next phase had already begun.

The joint project between ASX and Digital Asset Holdings mirrors RISE's effort in several ways, with the same concerns over permissions and restrictions, but differs by actually replacing the settlement system entirely with a blockchain-based solution. This wholesale change necessitates more work, but allows greater automation and potentially lower costs in the long run.

Regarding the importance of security and creating a permissioned network, ASX deputy CEO Peter Hiom said at the exchange's 2016 results presentation: "Public blockchains are operated largely in unregulated marketplaces where anyone can join and access those markets anonymously via a public, or unpermissioned, network. Network security is public to scrutiny and if compromised it could allow someone to anonymously and unilaterally transfer cryptocurrency on the public network. This is clearly unacceptable in the types of highly regulated markets within which the ASX operates."

Despite positive steps and recent developments, the road ahead is still long. While RISE has a well-constructed model, it has not yet moved on to a pilot scheme, and is still far removed from broad adoption. Meanwhile, the ASX CHESS replacement project has scant little to offer in terms of detail.

In fact, according to an August 2016 report by Celent, a financial IT research and consulting firm, the only large financial services area to have seen a blockchain-based project even enter the pilot stage is in cross-border payments. Ripple Consensus Ledger, developed by Ripple Labs, is of particular note, with more than 30 pilot schemes completed and an imminent production stage planned.

While progress towards market rollout has been slow, Celent warns against presuming the pace will remain sluggish. A recent successful proof of concept test for a distributed peer-to-peer network covering single-name credit default swaps gives hope that the speed of change will increase. The test, run by a working group that included four banks, the DTCC and Markit "represents a very important milestone in the development of distributed ledger technology in the capital markets," according to Celent.

The test demonstrated the use of smart contracts within a highly complex market environment, validating their use and providing a roadmap for further development across the financial markets. These contracts, which allow users to program automatic actions based on data inputs and criteria – the ability to automatically distribute dividends for example – are integral to making distributed ledger technology fit for purpose. A proof of concept for such an important part of the blockchain environment "does indicate a high level of throughput and scalability, indicating that the pace to maturity of distributed ledger technology in the capital markets could surprise people."

Lisa Pollina, a former vice chair of RBC Capital Markets, has joined the board of US post-trade giant **DTCC**. The industry veteran will work on the board's audit, finance/capital and risk committees. She joins following her role as vice chairman for RBC Capital Markets. Before RBC, Pollina worked at Bank of America where she was responsible for a global corporate banking division serving clients in Asia, EMEA, Latin America, Canada and the US.

Joan Kehoe, founder of fund administrator Quintillion, is joining **JPMorgan** as global head of alternative investment services. Her appointment follows the recent hire in April of Garrett Breen as a managing director of alternative investment services. The bank is redoubling its commitment to the wider custody & fund services (CFS) business which has been led by Teresa Heitsenrether since June last year who was previously global head of prime brokerage.

ASX has appointed **Dominic Stevens** as its new chief executive, replacing Elmer Funke Kupper who resigned in March. Stevens has served on the Australian exchange's board since 2013, and was the CEO of investment firm Challenger between 2008 and 2012. He will start in the new role immediately.

Apex Fund Services has hired three new individuals from KPMG, State Street and JPMorgan respectively. **Nitin Khanapurkar**, who joins from his role as a senior partner at KPMG, becomes Apex's global head of risk and compliance oversight. Apex Luxembourg has appointed **Sonja-Maria Hilkhuijsen** as head of European compliance and data protection and **Gareth Williams** as managing director for the office. Hilkhuijsen joins Apex from State Street Bank Luxembourg. Williams joins from JPMorgan, where he has held a senior vice president role for seven years.

Digital Asset, the blockchain firm set up by former JPMorgan executive Blythe Masters, has made a number of senior hires. **Carol Mathis** has joined as chief financial officer from RBS Corporate and Institutional Bank. **Kelly Mathieson**, former head of JPMorgan's global collateral management and securities clearing businesses, has been hired as a product manager. Meanwhile **Gavin Wells**, who spent eight years at LCH. Clearnet, becomes head of Europe for Digital Asset while Bank of America executive **Gordon Weir** is the firm's new head of delivery. **Andrew Pisano**, who helped define derivative exchange CME's blockchain strategy, has been appointed as business development director.

Citi has appointed **Jervis Smith** as the bank's head of investor services for Luxembourg, a new role reflecting Citi's focus on the country. Smith, who has more than 30 years of industry experience, was most recently Citi's head of sales for the bank's APAC securities services business. His appointment continues Citi's build out of its custody and fund services capabilities, following last month's hire of JPMorgan's Patrick O'Brien as head of fund services in Ireland and head of offshore business development for Ireland and Luxembourg.

BNY Mellon has appointed **Hani Kablawi** as its new head of investment services for Europe, the Middle East and Africa. London-based Kablawi will lead the business strategy for the firm's investment services division, leaving behind his previous role as BNY Mellon's head of asset servicing for EMEA. Kablawi will report to Brian Shea, BNY Mellon's CEO of investment services, and Michael Cole-Fontayn, Chairman of EMEA.

Carl Smithies has joined **ABN Amro Clearing**'s securities lending team in London. Smithies, a former stock loan trader at Sumitomo Mitsui Trust International, joined the Dutch bank last month. He worked at Sumitomo Mitsui Trust for five years from 2011. He has also previously held roles at Merrill Lynch, Citi and Northern Trust.

David Linds has joined **RBC Investor & Treasury Services** as managing director and head of asset servicing for Canada. He joins from CIBC Mellon, where he worked for 19 years, most recently as senior vice president for business development and relationship management. In his new role, he will be responsible for sales and client coverage activities across Canadian sub-custody and other asset servicing segments. Based in Toronto, he will report to James Rausch, head of Canadian client coverage.

Pacific Fund Systems, a provider of fund administration software, has made two new appointments to its new European headquarters in the Isle of Man. **Erich Carshagen**, previously a senior business analyst for PFS Paxus, is relocating to the island, to take on the same role at PFS. He will assist with client training and providing support materials. **Andrew Harrison** also joins as a junior business analyst, providing support to PFS's global client base. Previously, he has held fund accountant roles at fund administrators, and has recently returned to the finance sector.

HSBC Securities Services has appointed **Paul Heffernan** as head of cross-border sales for securities services in EMEA, responsible for driving business development and guiding international fund managers establishing offshore traditional and alternative investment structures. He joins HSBC from Northern Trust, where he was a global funds business sales executive with a focus on the European markets.

Maples Fund Services has appointed **James Perry** as head of institutional investor solutions, responsible for shaping the firm's offerings and enhancing its service delivery to institutional investors. He brings more than 20 years of investment management experience, the past 10 serving in senior investment roles overseeing portfolios of public assets in California and Texas. He was previously chief investment officer of the Dallas Police and Fire Pension System.

New ways of working

Andrew Neil speaks to Mick Chadwick, the head securities finance at Aviva Investors, ahead of the annual IMN conference for European beneficial owners

Optimised collateral management and securities financing is moving ever closer to the centre of treasury, trading, risk and operations activities for fund managers and insurers globally. This has certainly been the case for Mick Chadwick at Aviva Investors, who oversees securities lending, repo and related transactions in both fixed income and equity markets on behalf of all entities of the global insurance giant Aviva.

"As a securities finance desk, our mandate is now two-fold," he explains. "On the one hand there's our traditional securities lending function, unlocking maximum value out of assets, which remains important. However, in order to do that effectively and with maximum efficiency, we've had to develop significant expertise and invest in infrastructure around collateral management.

"We're increasingly being called upon to leverage that expertise for the benefit of other parts of the firm. It's an evolution, or extension, from a traditional securities lending mandate to an all-encompassing collateral solutions provider to the wider business."

Chadwick's team of twelve includes traders, operational support and control staff working closely, looking after the full lifecycle of securities finance transactions across fixed income and equities for a number of funds run by Aviva Investors, as well as the wider insurance group's pension fund and all other Aviva units engaged in lending and borrowing.

Diversity

The sheer scale and diversity of strategies and risk appetites of Aviva-owned entities means the firm's securities finance desk is no less sophisticated than other agent lenders. Although Chadwick and his team aren't aggressively pitching for third-party mandates on a standalone basis, there remains a meaningful book of external business, which is usually embedded as part of a broader Aviva Investors mandate.

This means the unit is also alert to the full range of wider industry trends and revenue generating opportunities. "There's a certain bifurcation going on within the securities finance industry," explains Chadwick.

"On one hand you have the collateral transformation business, where participation levels are high from funds invested in high-quality liquid assets. For that approach to be successful, funds need to be flexible around term structures as well as collateral criteria – but not all funds have the appropriate risk appetite or liquidity profile and others are simply not permitted by regulation to participate in that activity.

Mick Chadwick

"At the opposite end there is an ongoing focus on specials, a lower-volume yet higher-margin business where strategies focus on a specific security or event."

Chadwick argues that his unit has somewhat of a competitive advantage, given that it is run out of an asset management business. "We have a direct relationship with the decision makers of the underlying funds and can be nimble when it comes to things such as corporate actions and event-driven trading opportunities. There's a high level of coordination, which allows us to move more quickly than some of our peers in the custody universe."

Before starting at Aviva Investors in 2006, Chadwick spent most of his career as a borrower in the fixed income markets, working for various investment banks, building and running repo desks for Lehman Brothers, UBS and HBOS Treasury Services. Although regulatory reform and technical innovation have been ever-present during that time, Chadwick acknowledges that the pace of change is demanding on market participants and certainly paves the way for new ways of doing business.

Whether that's more CCP adoption, peer-to-peer lending, a reliance on synthetics or a mixture of each remains to be seen. Chadwick says all of these initiatives tend to be driven primarily by the sell-side and are a result of investment banks being forced to adapt to a new balance sheet and regulatory capital regime.

"There's an assumption in some quarters that the underlying beneficial owner clients will come on a journey with them. However, that assumption is not valid for all clients.

"Take CCPs for example, that's a fundamental change compared with the current OTC or bilateral modus operandi. In order to really persuade a significant part of the market to participate in CCP transactions, a certain level of engagement, scale, expertise and will is required on behalf of the client before they will look at that alternative. At the end of day, the lending models of the future will come down to economic incentives."

Mick Chadwick will be speaking at The 21st Annual European Beneficial Owners' Securities Lending & Collateral Management Conference, hosted by the IMN, 22-23 September in London

Upended perceptions down under

Lending is becoming better understood, more accepted and widely adopted among Australian super funds. *Andrew Neil* reports from *Global Investor/ISF*'s Securities Finance Masterclass in Sydney

Often seen as high risk and a straight proxy for short selling, the securities lending industry was demonised by the Australian press in the years after the financial crisis. However, as education and industry practices have improved, perceptions among local investment houses and institutional investors have started to shift, particularly among the large superannuation funds.

"The global financial crisis was the first major market event that exposed the gravity of counterparty and cash reinvestment risk within the securities lending market," said Dane Fannin, head of capital markets APAC at Northern Trust at the *Global Investor/ISF* event. "However, the securities lending product has since evolved as a cleaner and more flexible offering and the industry is dealing with these risks more robustly. Programmes can now be fine-tuned and customised to enable clients the ability to deploy the necessary 'speed bumps' to mitigate risks and achieve the desired level of risk and reward for the product."

Malcolm Poes, senior treasury manager at AustralianSuper, a $100bn pension fund, was also in attendance at the *Global Investor/ISF*'s fifth Sydney event. Poes joined the fund in 2012 and was tasked with, among other things, rejuvenating AustralianSuper's securities lending operation.

"Securities lending took a backward step after the financial crisis – there wasn't a heavy focus on keeping up to date," he acknowledged. "I looked at what could be improved. This involved accessing income generation, utilisation rates, risks and new opportunities."

Engaging stakeholders

Getting all of his relevant colleagues engaged, educated and onboard was tough, Poes recalled, joking that he made plenty of new friends along the way. "Portfolio managers, tax & compliance teams, auditors, senior managers and ultimately the board – there had to be extensive and direct communication with all divisions internally." So much so that Poes developed an FAQ sheet on securities lending with 78 questions he knew would be coming his way.

"You have to answer concerns and demonstrate the fact that, yes, you have exposure in a securities lending programme – but you're dynamically marked to market every day and there's an exceptionally low probability of a default."

After it has been agreed upon internally, Poes added that securities lending has to be managed properly. "Putting this type of investment activity at the back of the queue and checking a programme once a month isn't an option. That heightens risk and wastes the opportunity of developing a close relationship with an agent lender, which could help generate meaningful income that can eventually be deployed elsewhere within the fund."

Natalie Floate, head of ALM, FX & agency lending, Asia Pacific, BNP Paribas Securities Services, has encountered a variety of attitudes to lending – sometimes within the same organisation. "We've found a number of different dynamics and attitudes toward securities lending in Australia and elsewhere in the APAC region, particularly between those that have or haven't lent previously.

"In Australia, finding the key stakeholders is crucial. There may be individuals who have a certain view on securities lending or experienced a bad situation previously. Our job is to reach the right individuals, understand their concerns, walk through them through those issues and explain the potential benefits."

HQLA demand

The panelists agreed that engagement levels had improved markedly within the last few years, particularly in Australia. However, as much of the dialogue is actually occurring on the demand (borrower) side, driven by a strong demand for high quality liquid assets (HQLA) due to Basel III's Liquidity Coverage Ratio.

The requirement to hold increased levels of HQLAs is creating consistent demand to borrow government bonds and, in turn, an opportunity for asset owners.

Another reason for increased engagement from the lending community is indemnification. "Indemnified programmes require agent lenders to hold more capital," said Sam Watkins, executive director securities division, Goldman Sachs Australia. "As a result there's a greater focus on indemnified trades and the way that insurance is used. If you're a beneficial owner and you're not indemnified, the risk sits squarely with you, hence why engagement from asset owners has increased so much and will continue to do so."

It's not what you know...

Chris Caruso, founder of Pangaea Business Solutions, says when it comes to managing a crisis between counterparties it's the importance of strong relationships that matter

"Relationships within a hedge fund not only need to be broad but vertical. What this means is that each senior person, and at junior level too, needs to develop and maintain relationships at the counterparties"

With our current fixation on the alphabet soup coming out of Basel III and other financial regulations it is sometimes easy to lose sight of the importance of relationships, especially in a crisis.

The back and forth between hedge funds and their prime brokers has devolved into a narrow conversation on profitability and returns. However, in a crisis just being a good client above the ROA hurdle may not be enough.

Moreover, the ever-increasing turnover at the bulge bracket banks further highlights the risks to not having broad relationships and a process to develop new ones.

Some hedge funds rely too much on their primary coverage and neglect developing relationships more broadly. This approach has two main risks. Firstly, your coverage person may not have the influence you need in a crisis. And secondly, if that coverage person leaves the bank you are basically starting over.

Relationships within a hedge fund not only need to be broad but vertical. What this means is that each senior person, and at the junior level too, needs to develop and maintain relationships at the counterparties. There are risks if the hedge fund doesn't develop multiple touch points for each senior person at the firm. Depending solely on someone such as the COO creates the same risks: the COO may not be able to reach high enough into the bank's management in a crisis and if he or she leaves, the hedge fund loses its primary connection to the counterparty.

Relationship maps

One way to approach this issue is to create a relationship map. The process is as follows: Make a list of all the people at the hedge fund that interact with their counterparties. List all their relationships and the quality of them i.e. how well they know them, who their primary contacts are and how long they have known these people.

In addition, make a list of the other people they should know. These are the holes in their relationship map. Perhaps the treasurer interacts primarily with the deputy risk officer but doesn't have a relationship with the head of risk. Relationship holes could also have been created by primary contacts leaving. Again, the consistent turnover at the banks is creating holes all over people's relationship maps these days.

Finally, create a plan to develop those new relationships. This doesn't happen right away. Your plan should be that over the next three to six months you would make progress on developing your new relationships (e.g. in lunches and meetings).

So many things in a crisis are unpredictable and out of your control. Developing and maintaining relationships at your banks is not one of them. You can control this.

Success and failure, especially in a crisis, can hinge on the smallest of things. A strong relationship with a key decision maker could make the difference in effectively managing a crisis between you and one of your counterparties.

In the end, it's who you know and how well.

Pangaea Business Solutions was founded in September 2012 with the primary mission of helping hedge funds and hedge fund investors better understand and manage the risk they are taking with the counterparties that are holding their assets. Prior to founding Pangaea, Caruso was most recently Deutsche Bank's North American head of relationship management for prime brokerage business where he and his team were responsible for covering the group's largest clients. From 2001 to 2010 he was US head of prime brokerage.

Technology transfer

A large number of leading securities finance figures are reappearing at technology companies, using their market expertise to build next generation solutions. *Andrew Neil* investigates

It is nothing new to see senior market participants moving into other parts of the financial industry but the stream has become a torrent in recent months. Numerous leading industry figures, many of whom have spent decades in agency lending, prime brokerage, repo and derivatives roles are switching to the technology vendor side of the business.

Blockchain start-ups are one group poaching a significant number of senior executives. Last month, Kelly Mathieson, the former head of JPMorgan's global collateral management and securities clearing businesses, switched to distributed ledger specialist Digital Asset.

Likewise, fintech entrants specialising in collateral management and other areas are adding years of expertise to their ranks. Lee McCormack, a senior derivatives clearing and market infrastructure executive who has worked at Nomura, Morgan Stanley and UBS, resurfaced at CloudMargin last month.

Ben Challice, chief operating officer at Pirum Systems, which provides tech-based services to support post-trade risk and collateral management in the securities lending and repo markets, similarly made the switch from his role as head of global prime services at Nomura earlier this year.

"There's a growing appetite among industry participants to try somewhere truly entrepreneurial," explains Challice, who has also held executive roles at Lehman Brothers and Goldman Sachs.

He isn't surprised to see an increasing number of market participants opt for a career change given what he describes as the "cyclical challenge" facing investment banks generally and securities finance in particular.

"Revenues are under pressure and there is a heavy focus on controlling costs. That limits investment and hinders innovation. At the same time, this is a pivotal phase for the industry where technology-driven innovation, greater automation and efficiencies are being demanded by the market. Being part of the solution, rather than reacting to problems, is exciting."

> **"Being part of the solution, rather than reacting to problems, is exciting"**
> BEN CHALLICE, PIRUM SYSTEMS

Challice says he feels reinvigorated by his switch to Pirum. "As well as improving efficiency, the regulators and therefore the market are looking to manage risk and capital, and now – given SFTR – report in a sophisticated, real-time way. Pirum is uniquely placed to meet those needs."

In a similar move during July, Ross Levin joined Pleeco, a New York start-up that helps banks, broker-dealers and buy-side firms to optimise their balance sheets, cash, capital, funding and collateral across asset classes and business silos. Levin, who built Itau's US multi-asset prime brokerage business from the ground up and has held senior roles at ABN Amro and RBS, has a slightly different take on the industry trend.

"Banks are struggling to retain top talent as more and more workers either join financial technology startups, or leave to form or join consulting firms," he explains. "The latter trend has been in play for as long as the industry itself. The former, however, is a brand new phenomenon that is a reflection of the financial industry."

According to Levin, the most important reason is that since the financial crisis of 2008 banks have gradually stopped working on innovative products or services, instead moving into regulatory and compliance mode, which is, while critical to undertake, less stimulating for someone with a creative mind.

The second reason is a product of technological progress. As banks are

becoming more and more technology-driven, technology companies' success is directly related to the systems and services they provide to financial institutions. Their fortunes are more intertwined than ever and new systems on offer are nearly always led by experienced industry practitioners.

Industry knowledge

Jonathan Lombardo, senior vice president of funding and financing services at Eurex Clearing, argues that technology companies looking to make inroads into the industry cannot build effective systems unless they have specific expertise, which can only come from someone who has been working in the business itself and has deep insight into how it operates. As such, technology companies must actively search for those on the business side to join their ranks.

"In my opinion, there are too many moving parts that prevent someone from building technology for the securities finance market without having had industry experience," adds Lombardo, who has also worked at Pirum, Citi and SecFinex, an electronic stock lending and borrowing platform that closed in 2011.

There are, according to Lombardo, too many securities lending specific nuances, niche processes that need to be considered. "It's not easy to create a plug-and-play solution from scratch," he adds. Eurex Clearing's own securities lending central counterparty clearing (CCP) service in Europe, for example, made use of existing technology at Pirum, EquiLend and Eurex Repo's F7.

Lombardo admits it made sense to use existing technology, developed by expert vendors, as part of the system building process. "Using our own expertise as well as trusted technology partners backed up by years of industry experience made the development of the platform easier. It also meant our clients didn't have to do any heavy lifting."

Roy Zimmerhansl, global head of agency lending at HSBC Securities Services, has spent the past three decades working in and around the securities finance industry. He has also held roles at investment banks, brokers and a central depository as well as operating as an independent consultant and owning a training company.

He has also worked as a product specialist at a software company Trading Apps between 2011 and 2013 and built an electronic platform for equity lending at ICAP in 2006.

"Broadly speaking, technological changes in this market don't happen as quickly as we all expect them to," explains Zimmerhansl, who chaired a securities lending technology user group back in the late 1980s. "There have always been technically gifted people in and around the industry, but these individuals have traditionally lacked an understanding of the business drivers. Senior managers in agency lending and prime brokerage roles need technology that fully supports their day-to-day business functions and long-term aims and objectives."

The higher number of market participants appearing on the technology side of the business should result in a greater number of high quality next generation solutions becoming available.

> **"Banks are struggling to retain top talent as more and more workers... join financial technology startups"**
> ROSS LEVIN, PLEECO

It is often the case that dedicated technology companies can provide the same or better solutions at a significantly reduced cost, and they are capable of building them in a much shorter time period than banks are able to internally.

"There is no argument that technology companies can build better systems that banks – just like banks provide better financial services than technology companies," adds Pleeco's Levin. "However, for an IT company to be successful, they need experienced financial specialists with deep industry knowledge. This is why we see so many industry veterans joining technology start-ups. Although wearing a t-shirt to work is a reason that should not be discounted."

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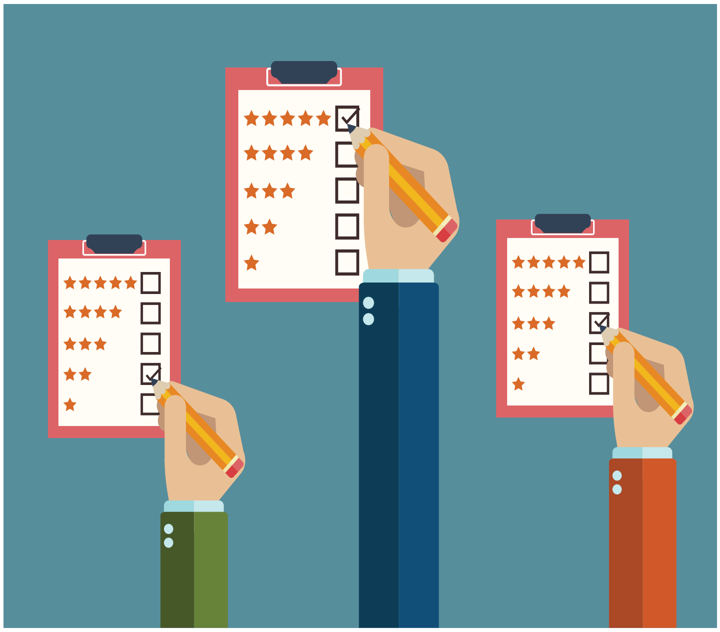

The rate of change across securities finance industry is spurring demand for consulting services. *Andrew Neil* takes a close look at the solutions and expertise on offer

When an operating environment rapidly becomes more challenging and technically complex an army of independent advisers and consultants often springs up in its wake. This is certainly the case in securities finance, where entities, predominantly on the buy-side, are seeking to ensure key functions are regulatory compliant and operationally efficient.

There are more solutions on offer to beneficial owners, asset managers, hedge funds, prime brokers, institutional investors, corporates and custodians than ever before. Consultants, outsiders offering a pragmatic perspective, are increasingly in demand due to their promise to expose critical flaws, identify areas of improvement or simply provide reassuring third-party verification. But what type of provider is best to turn to?

"That entirely depends upon the full purpose of the engagement but certainly one that can offer independent advice," explains Steven Baker, director, securities finance consultancy and product management at IHS Markit. "For instance, if purely seeking a legal opinion then a law firm with appropriate expertise may suffice, if only investment advice, an agent lender.

"However, most engagements not only require securities finance and collateral market expertise, but also a broad range of accurate and detailed historical data. As the required data often crosses adjacent data sets such securities lending, repo, collateral pricing and liquidity metrics, a firm with both industry and data expertise seems best."

IHS Markit has been providing securities lending data since 2012 when it acquired DataExplorers, which itself been around since 2002. SunGard and DataLend also provide data services, and each have different data sets and strengths in particular markets.

Holistic perspective

Oscar Huettner, managing principal of LGM Financial Consulting, agrees that market participants must look across all areas of a firm and recognise the common themes, which often revolve around deploying assets in the most efficient way possible. "For example, getting everything correct on the repo desk, while giving away money margining derivatives contracts on an exchange is counterproductive.

"A front, middle and back office [solution that is] cross-product and has a global focus is required today. There would be limited appeal, therefore, if a consultant were to simply market him or herself in one area of expertise. A consultant has to offer front office advice and speak with authority to the back and middle office teams."

Huettner's latest project is with DTCC and Euroclear's Global Collateral platform, which aims to create a global collateral management platform by mobilising DTCC and Fedwire securities on to the Euroclear Collateral Highway for use in secured financing transactions and to support OTC derivatives margining. The scope of his assignment includes operational design, legal/regulatory structure, sourcing of reference data and client integration. The former Barclays (Capital) director of repo trading and BondLend global product manager adds that consultants need a wide-ranging set of skills to operate in this market.

Earlier this year Broadridge acquired securities finance and collateral tech vendor 4sight for an undisclosed fee, extending the firm's front-to-back office securities lending, repo processing, synthetic financing and collateral management capabilities.

Jerry Friedhoff, managing director of securities finance and collateral management at Broadridge, agrees that consultants must have global coverage and cover all products. He believes that the evolving environment offers tremendous potential for firms to build competitive advantage, perhaps aided by a consultant. "By capitalising on the synergies between collateral management and securities financing, firms can focus on optimising collateral to reduce risk, improve liquidity and ultimately increase revenue," he says.

Friedhoff says the acquisition made strategic sense as 4sight was the only completely-integrated vendor covering equity, fixed income and derivative inventory in a holistic way.

"Regulators have placed collateral management and securities financing at the center of every firm's treasury, trading, risk and operations activities," he says. "Businesses are coming together more and more. Repo, securities lending and the associated collateral management are no longer siloed.

"It's clear that the securities finance market is here to stay. There are significant funding needs and strong demand for tools and expertise to help navigate complexity. The addition of 4sight enables us to meet that demand."

There has been a growing number of consultants appearing across the industry offering a range of services. However, this isn't an entirely new trend says Ed Blount, executive director at the Center for the Study of Financial Market Evolution: "There have been periods of dramatic change across the securities finance industry that have prompted firms to seek independent advice and third-party solutions. The introduction of listed derivatives, for example, triggered another wave of consultants [emerging] in the late 1980s."

Blount, the founder of Astec Analytics, now part of FIS SunGard, adds: "I take exception when people say there is an 'unprecedented demand' for consultants. However, regulation and the threat of litigation following the crisis has undoubtedly created a strong need for solutions."

Regulatory pressure

Regulation and compliance is likely to be the key concern for clients. Risk-weighted capital levels must now factor in securities lending and obligations to indemnify client exposure. Indeed, the required level of indemnification and its cost remains one of the substantial issues facing the industry.

The liquidity coverage ratio (LCR), which requires banks to maintain a sufficient stock of high-quality liquid assets (HQLA) to meet their needs over a 30-day stress scenario, is putting pressure on the cash reinvestment side of lending programmes in relation to making longer term investments.

Additionally, as LCR is also drastically changing the value of different forms of collateral, driving lending fees higher for HQLA and cash re-investment repo rates higher for alternative collateral types. It is unclear how programmes can adapt to take advantage of this and its potential impact on performance and risk.

"Our industry, our market, is mutating… There is an obvious need for securities finance consultants"
SEBASTIEN BEITHO, ALCOGNIS

Basel III and EU directives are also having an impact. "The [Basel III] leverage ratio, which is constraining bank balance sheets and motivating lenders to accept alternative collateral types, is raising questions on how to price deals versus different forms of collateral and measure the associated collateral risks," adds IHS Markit's Baker.

"Solvency II is also driving greater needs for collateral reporting. And last, but certainly not least, MiFID II is placing more pressure on beneficial owners to demonstrate best execution. It is also driving the need for more frequent independent data and reviews of their security lending programme performance, risks, legal structures, operational processes and regulatory compliance.

"As a result, given their fiduciary responsibilities, we are seeing more activity on the beneficial owner side for benchmarking services, to assess programme performance and risks, to support their RFP process and opinions or surveys on fee splits – in particular, when considering changes to their level of indemnification."

The combined effect of the many regulatory initiatives is transforming the industry and some participants may be struggling to keep up. "Our industry, our market, is mutating," adds Sebastien Beitho, founder and chief executive of Alcognis, a Paris-based consultancy dedicated to securities finance. "There is an obvious need for securities finance consultants. Hence, newcomers are trying to penetrate the industry based on regulatory changes.

"Demand is also being driven by business efficiency and profit generation. Margins are very low and market participants need to adapt to changes globally including trading, balance sheet optimisation, collateral optimisation and management, systems, operations and new infrastructures such as CCPs."

Formed in 2012, Alcognis offers front-to-back solutions including trading, operations, systems, regulation, legal, market infrastructure and market data. "We focus only on the securities finance industry and cover the full scope of the industry so that our clients can leverage on our expertise to build, restructure or reorganise an efficient and profitable securities finance business," adds Beitho, who was previously Fortis Investments' head of securities finance trading and head of the BNP Paribas agency lending desk in Paris.

"A consultant has to offer front office advice and speak with authority to the back and middle office teams"
OSCAR HUETTNER, LGM FINANCIAL CONSULTING

"When we are taking securities finance we are touching the core of the financial industry functioning and liquidity. It is a core matter for the sell side and the buy side. For both, their securities finance business efficiency and profitability is fundamental in ensuring their global business to continue operating normally. Because the securities finance and collateral management business is so fundamental, the sell side and the buy side need professionals that understand the market and consultants that have market and industry experience."

Standard Bank's **Juanita Taylor** is the new chair of South Africa's securities lending body **SASLA**. The appointment follows the departure of James Burgess from Macquarie Securities earlier this month. Burgess had taken on SASLA chairman duties in March but has relinquished his role as part of the move away from Macquarie. Johannesburg-based Taylor is head of securities lending at Standard Bank, a position she has held since 2013.

CloudMargin has hired former JPMorgan executive **Lisbeth Hadingham** as its North American head of sales. Based in New York, Hadingham will be responsible growing the tech firm's client base and enhancing its collateral management, OTC derivatives and capital markets services. Most recently she worked at FIS, formerly Sungard, and has also spent over a decade at JPMorgan. Her appointment follows on from CloudMargin's recent hire of **David Little** from Calypso Technology as non-executive director.

Ramir Cimafranca has joined **Societe Generale** as the new head of prime services in Japan, which encompasses prime brokerage, clearing, global execution services and secured financing. Cimafranca joined the bank from Newedge, a derivatives brokerage which SocGen took full ownership of in 2014 after Credit Agricole relinquished their half ownership.

Securities finance veteran

Ross Levin

Ross Levin has joined fintech firm **Pleeco**. Based in New York, he will spearhead business and product development for the start-up. Previously Levin has built a multi-asset prime brokerage business from ground up at Itau in the US. The tech expert has also held senior roles at ABN Amro and RBS during his career. Speaking to Global Investor/ISF, Levin, who set-up his own consulting business Primetech Management last year, described Pleeco's technology as "unique" and a "new paradigm" for the securities finance market. Founded in 2013, the start-up's mission is to improve sustainability and resilience of systemically important financial institutions.

Casey Whymark and **Duncan Wilson** are leaving the board of securities lending trade body **ISLA**. UBS's Whymark and JPMorgan's Wilson will step down this year. Whymark took up board responsibilities in 2014, Wilson followed a year later. Two new board members are expected to be appointed by the end of 2016.

JPMorgan prime brokerage veteran **BJ Marcoullier** has left the company, Global Investor/ISF understands. He first joined the US investment bank in 1994 and went onto manage the firm's Americas securities lending desk. Marcoullier's most recent role was head of the North American liquidity and collateral team within JPMorgan's equity finance division. He has also served on Equilend's board of directors having previously held the title of chairman. A JPMorgan spokesperson declined to comment.

BNY Mellon executive **Jeannine Lehman** is leaving the US custody bank. It is understood that Lehman, who manages BNY Mellon Markets' global collateral management and segregation business in EMEA, is taking early retirement. She currently oversees a team of 60 and has been responsible for driving business growth, product management, client relationship management and regulatory issues. She began her capital markets career in derivatives sales at Continental Bank in Chicago before working in Chicago, London and Amsterdam for Bank of America and ABN Amro.

Former UBS and Merrill Lynch executive **Kevin LoPrimo** has joined **Cowen** as managing director, head of international prime brokerage. LoPrimo spent nearly five years at Global Prime Partners where he set-up the first European-based boutique prime broker servicing hedge funds with assets under management of less than $200m. Before that he worked at UBS and Merrill Lynch in various prime brokerage roles. Cowen Prime Services was formed last year following the wider group's acquisition of Concept Capital Markets.

Lombard Risk Management has appointed **Tracey Adams** to head the development and implementation of the firm's collateral and clearing platform COLLINE in the APAC region in a newly created role. Adams joins role from FIS where she worked as a senior sales and account executive for collateral and securities finance, working closely with the FIS Collateral Management team to direct their EMEA sales strategy. The web based COLLINE system is a collateral and inventory management, clearing and optimization solution which allows clients to consolidate their collateral management onto a single platform by supporting multiple asset types.

Sean Bunyan has joined **Standard Chartered** as the firm's new head of financing sales for Asia. Hong Kong-based Bunyan will help drive forward the repo and financing flow franchise for the region and report to Terence Gan, global head of rates sales at Standard Chartered Bank. The new hire previously worked at Morgan Stanley in Hong Kong as head of financing sales for Asia. Bunyan has also held roles at JPMorgan and Goldman Sachs.

Emily Portney has been appointed as CFO of the **Barclays** corporate and international business. Portney will join Barclays in her new role in mid-September. Previously, she spent 22 years at JPMorgan in roles including head of agency clearing, collateral management and execution and CFO of equities and prime services.

Europe's forgotten frontier

Central and Eastern Europe is suffering negative fund flows despite solid fundamentals. *Matt Smith* asks whether fund managers should take note

Fund flows into Eastern Europe were negative in July, extending the trend for emerging Asia and Latin America to be the main focus for non-resident emerging market (EM) investors. Europe's former communist countries offer steady economic growth, robust currencies, relatively cheap stocks and decent bond yields – but few fund managers seem impressed.

"Eastern Europe is an area that has been out of favour for several years," says Chris Colunga, co-manager of BlackRock's Emerging Europe Investment Trust, citing sanctions against Russia, political unrest in Turkey and a change of government in Poland.

EM equity markets received non-resident portfolio inflows of about $14.6bn in July, while an estimated $10.2bn went into EM debt, according to the Institute for International Finance (IIF).

EM Asia and Latin America attracted inflows of $19.1bn and $8.7bn respectively, while EM Europe and Africa and the Middle East suffered modest outflows.

Uncertainty ahead of Britain's referendum on leaving the EU probably caused fund flows into Eastern Europe to slow or reverse this year, says Ugras Ulku, IIF senior economist for emerging Europe. Expectations that the Brexit vote will dampen demand for Eastern European exports is likely to keep fund flows lackluster, he adds.

The fund flow trend is less concerning to Central and Eastern Europe's EU members. These will receive EU-targeted fund flows worth about 3% of their GDP for the next five to seven years, giving them greater stability and less reliance on other fund flows, says Zoltan Arokszallasi, a senior analyst for emerging Europe at Austria's Erste Group.

Eastern European currencies have been relatively stable over the past two years, whereas many emerging market currencies have fallen 30-50% versus the dollar and could face further weakness if the US Federal Reserve hikes interest rates.

"The greatest opportunities usually occur in the overlooked, out of favour areas. For those willing to look beyond the headlines, Eastern Europe has much to offer," says Colunga. Cheap stock markets are one such attraction; MSCI's Emerging Maarkets Europe Index had a price-to-earnings ratio of 10.53 at the end of June, compared with the global EM equivalent at 13.80 and MSCI World at 19.21.

"Free cash flows are improving substantially, supporting dividend yields. Companies are being smart about their capex now," says Colunga. This is bringing greater returns to investors and fund flows into Eastern European equities and debt will increase over the next 12 months, he predicts.

Eastern Europe 10-year bond yields vary, from Poland's 2.72% to Hungary 2.88% and Romania's 2.98%. Those are higher than the likes of Taiwan's 0.67% and Thailand's 1.98%, but are dwarfed by Russia's 8.4% and Turkey's 9.6%.

Diversity is strength

"In Eastern Europe we have a wide, diverse pool of investments from which we can draw to take advantage of the current market opportunities," says Colunga. "The best time to buy emerging markets is when currencies are weak, markets are cheap and GDP growth is depressed. These conditions exist now. Flexible exchange rates have allowed Eastern European economies to respond to global conditions and ensure their economies remain competitive. The governments are focused on lifting GDP growth and yet the stocks do not reflect these realities."

He cites data showing Turkey's stock market and currency are trading close to their cheapest ever levels historically even though the country offers a large, young population and low-cost, increasingly skilled labour force on the EU's doorstep. New capital market instruments are emerging onto the scene. "This year also marks the first ever green bonds transaction in the region with a Turkish bank, TSKB, to attract institutional investors to finance a portfolio of green projects in all industries," says Tomasz Telma, director of Eastern Europe and Central Asia at the International Finance Corporation.

> "The greatest opportunities usually occur in overlooked areas. For those willing to look beyond the headlines, Eastern Europe has much to offer"
> CHRIS COLUNGA, BLACKROCK

Russia is also being overlooked after the oil price crash and sanctions ravaged its economy. Yet inflation is in retreat, lending rates are down, real wage growth is again positive and its real yield is among the highest in emerging markets.

Erste Group forecasts that Central and Eastern European economies will expand roughly 3% versus a 1.3% increase in the EU. "Eastern Europe offers higher growth than EU," says Erste's Arokszallasi. "It's also less risky than other emerging markets."

Turkey in trouble?

A new type of risk has been priced into Turkish capital markets following the July coup attempt but investor confidence should return to pre-coup levels in 2017, says *Ali Sökmen* of Control Risks

A month after the attempted coup, investors exposed to Turkey are still feeling the effects of the resulting uncertainty. Yet while a moderate negative impact bites in the short-term, Turkey's investment outlook is likely to see a return to its pre-coup state within the next year – characterised by instability but high returns.

Anti-coup demonstrators in Istanbul

Markets dipped in the immediate aftermath of the 15 July coup attempt. Both the value of the lira against the dollar and the BIST stock exchange fell by 7%.

As these metrics are indicators of investor confidence, their gradual upticks since 18 July are the beginnings of a cautious return to normality. The lira rebounded by 1.3% on the Monday following the Friday coup attempt, and despite setbacks over the past few weeks, it has tracked slowly back towards pre-coup levels. BIST-listed equities have also seen slow returns to health. This is largely due to a reduction in investor uncertainty over how the coup attempt will affect the government.

Measures by Turkey's central bank on 17 July designed to prop up the country's financial institutions by injecting "necessary liquidity, without limits" helped stave off some of the worst effects of the uncertainty – calming the currency and equity markets.

Despite these confidence-building measures, investors exposed to Turkey have been taught a harsh lesson: that a latent political risk existed, unbeknown to most, which now needs to be priced into future investments.

State of emergency

Further volatility was caused when President Erdogan declared a state of emergency on 20 July, leading to another decrease in the value of the lira. Despite this, the impact of the state of emergency on business in Turkey has been relatively limited.

Specialised businesses have faced the majority of controls under the state of emergency, particularly those that utilise explosives – such as mining companies. Minor operational hurdles have been put in place for these companies, including the requirement of tighter security measures and increased oversight. Yet this hardly amounts to wholesale disruption.

Turkey's travel and tourism sectors, which accounted for 13% of GDP in 2015, are likely to be the most adversely affected part of its economy. Already struggling due to a prolonged wave of terrorist attacks concentrated mainly in Istanbul and Ankara, the sector has now been hit further. Key destinations such as Istanbul and Antalya recorded drops of 35-40% in tourist arrivals in July compared to last year; figures for the following months will provide a clearer picture.

Despite efforts to control the situation, including government subsidies and diplomatic reconciliation with Russia and Israel, the attempted coup has meant that these measures are unlikely to have a positive impact on tourist arrivals until next year.

Domestic economy

Despite the recent negativity, consumer-orientated sectors will help drive growth over the next year. Sectors such as FMCG and food are unlikely to be heavily affected beyond the short-term, mainly due to Turkey's strong consumer demand. Demographics work to Turkey's advantage here, as a growing percentage of the population (67%) are at working age and there is a burgeoning middle class.

Key infrastructure projects such as the Avrasya Tüneli (Eurasia Tunnel), İstanbul Yeni Havalimanı (Istanbul New Airport), motorways and high-speed rail links are likely to remain a priority for the government. As these mega-infrastructure projects, expected to be completed by 2018, are a central part of the government's economic strategy, it is unlikely to let them fail.

Growing domestic demand for housing combined with interest from foreign investors, particularly from the Middle East, is likely to increase prospects in assets linked to construction.

All things considered, unless an unlikely further coup takes place, investor confidence will slowly increase over the next year from a "wait and see" approach to pre-coup levels.

Ali Sökmen is a Turkey analyst at Control Risks

Aramco alchemy

Saudi Aramco's proposed IPO is raising as many questions as answers, not least over which foreign bourse will host the overseas listing, writes *James Gavin*

Touted as the world's biggest ever public flotation, the proposed initial public offering (IPO) of 5% of state oil company Saudi Aramco is the cornerstone of the kingdom's bold economic reform drive. The listing promises not just to galvanise the sluggish listing pipeline of the Saudi Tadawul exchange, but have a truly global impact.

Investment banks have bid aggressively to advise on the float, which is not expected to hit the market until 2017. Much about the process is still unclear. The expectation is for downstream units to be sold, keeping investors away from the kingdom's hallowed upstream oil reserves – the source of its market power.

The valuation is subject to fevered speculation. The $2trn number most widely circulated could in the event be at the lower end of the curve yet would still yield $100bn – four times the size of the Alibaba offering in 2014.

"Listing Saudi Aramco is akin to listing the country of Saudi Arabia itself"
M R RAGHU, MARKAZ

"Listing Saudi Aramco is akin to listing the country of Saudi Arabia itself," says M R Raghu, head of research at Kuwait's Markaz. "Extensive work will be required in structuring and segregating assets that should form part of an IPO and those that would remain private."

Aramco has spent time furnishing facts and figures about its true reserve position, but transparent financial statements are lacking. "That's something that has got to change when the IPO comes out, as they will be under pressure to keep up with international disclosure standards," said Rhea Sthalekar, an analyst at Mumbai-based research firm Aranca.

Long-term observers of Aramco believe the company will be unwilling to give up such sensitive information. "I'm not convinced they will show up their oil and gas reserves or their full financial accounts. That would mean a massive change in culture," said Valerie Marcel, an associate fellow at Chatham House.

Much will hinge on where the proposed overseas listing will be. New York or London could be a game changer as it would signal positive intent from the authorities to increase transparency.

Competition from the other global exchanges to dual-list could be intense. "China is vouching for a dual listing of Aramco that would put the government-owned oil giant's shares on both the Hong Kong and Saudi exchanges in return for anchor investments from the Chinese funds," says Raghu.

The Hong Kong exchange had IPOs worth $34bn last year, surpassing the $30bn raised in the US. Winning the mandate would boost Hong Kong stature still further. "Moreover, 16% of Chinese oil imports are from Saudi Arabia – establishing a stake in Aramco could further increase the synergies between the countries," says Raghu.

Other analysts see London as the most likely international location to list Aramco's IPO. "Saudi Arabia is currently not one of the 28 jurisdictions recognised by the Stock Exchange of Hong Kong. In the case of Russian issuers, it also took a number of years for HKEx to come to the view that they could list in Hong Kong and it's questionable whether the process for Saudi Arabia could be fast-tracked," said Philippe Espinasse, a former regional head of equity capital markets in Asia and author of *IPO: A Global Guide*.

HKEx may try to woo Saudi Aramco to list on its platform. But, says Espinasse, international IPOs in Hong Kong have had a pretty disappointing run, as compared to those by Chinese issuers. "At the end of the day, Hong Kong remains first and foremost a platform to list Chinese businesses."

Whichever bourse wins out, the biggest impact will still be on the domestic Saudi market. "Locals might well sell other shares to free up cash for the Aramco sale. Foreign investors are unlikely to reach beyond Aramco given a rather downbeat earnings outlook," said James Reeve, deputy chief economist at Riyadh-based SAMBA Financial Group. "But if the Aramco sale allows the government to step up spending again, then most of the Saudi corporate sector should benefit."

Clearly, Saudi Aramco will need to become more transparent. "The main stumbling block, in my view, is that Aramco has a broad industrial role in the kingdom, and it may need to become more focused on its core business in order to satisfy shareholders," says Reeve.

Sukuk set to surge

The president of the Gulf Bond and Sukuk Association, *Michael P Grifferty*, says we are only at the beginning of the boom in Islamic debt

For the seven years of its existence the Gulf Bond and Sukuk Association (GBSA) has encouraged, both in public and privately, Gulf Cooperation Council (GCC) sovereigns to take the lead in building out our markets by raising funds. This year we are getting what we had been looking for – in spades.

What started in 2015 with these states absorbing liquidity from domestic banking systems morphed into $17bn in cross-border issuance so far this year. This amount is likely to jump significantly as countries that have not yet accessed the market, such as Saudi Arabia and Kuwait, as well as others that have previously issued tap the market. By year's end, observers who saw only an abyss in January when there were not two deals to rub together – okay, there were exactly two – will probably be looking back at a year of record volumes.

While the sovereign issues to date have been mostly in the conventional format, we feel that as states build their capacity to evaluate cost and risk we will see more sharia-compliant issuance. UAE emirate Sharjah started the year with a benchmark-size ijara sukuk structure and Oman came in during July with a privately-placed sukuk.

We are pleased that the states are building up their capacities to manage liabilities, an art that was mainly overlooked during the period of robust oil prices. As they do so, we think that a more strategic review will lead them to do the ground work that goes behind setting up sukuk programmes in order to benefit from the strong demand within the region and to balance out their exposure to global conventional investors.

From the investor's point of view, we see sukuk as a means to access what are, and will remain, a number of strong credit issuers across a range of sectors. Those who bought into GCC sukuk six months or a year ago have been amply rewarded. And, some observers within the region feel that international ratings procedures in some cases don't allow the agencies to fully reflect the obligors' strategic importance and hence under-estimate credit strength.

"It is increasingly clear to the new upcoming breed of debt managers in the GCC that local resources can be mobilised sustainably if the market is developed holistically"
MICHAEL GRIFFERTY, PRESIDENT, GBSA

We do not anticipate the strong appetite going away anytime soon so we would like to see more issuance from the region; asset prices should hold up well. Demand is anchored by regional buyers, including sharia–compliant banks but is increasingly global with strong placements into Asia, Europe and North America.

The Middle East is underrepresented in many portfolios and sukuk represent a means to diversify and get exposure to some great names that may not be very well known globally and are otherwise hard to come by. Ezdan Holding, DP World, MB Holding and Gulf Investment Corporation all chose Islamic structures this year, not out of necessity but by preference.

Think globally, act locally

GCC local currency debt markets are nascent by any standards but are increasingly coming to the fore. The states' initial reactions to meeting their growing fiscal needs, by drawing on funds from the domestic banking systems without much structure around the process, was not a constructive strategy.

However, it is increasingly clear to the new upcoming breed of debt managers in the GCC that local resources can be mobilised sustainably if the market is developed holistically. This should start by shedding light on primary price discovery, issuing in a predictable manner and in size, developing regional investors, improving market infrastructure and making it seamless for foreign institutions to participate and add needed liquidity.

With the World Bank projecting oil prices at or below $60 through to 2020, you can rest assured that an increasing share of financing will be driven by capital markets and increasingly by sukuk.

GBSA will continue to make Gulf governments and companies aware of the benefits of accessing the capital markets and telling their stories to global and regional investors. While we represent the broad debt capital market, our platform will be open to de-mystifying sukuk and other sharia-compliant assets to enable investors to take part in this solid regional story.

Rewriting the Riyadh rulebook

Regulatory change has risen to the top of the Saudi agenda and a root-and-branch reform of the legal framework is being implemented to meet investors' needs, writes *Matt Smith*

Saudi Arabia has begun the biggest shake-up of its economy since the kingdom was founded nearly a century ago as it aims to slash its dependence on oil. It means major changes are afoot in stock market and company regulations.

Bumper energy receipts had long enabled Saudi Arabia to remain isolated from global business culture, but the precipitous drop in oil prices and resulting cuts to state spending has prompted a dramatic re-think under the auspices of deputy crown prince Mohammed bin Salman, who this year unveiled Vision 2030, also known as the National Transformation Programme (NTP).

Certain reforms were already underway, but Prince Mohammed's appointment last year following his father King Salman's accession to the throne has accelerated the process.

A new companies law came into effect in May, replacing the previous iteration introduced in 1965. The new law makes it easier to create and operate local limited companies and joint-stock companies but also raises corporate governance standards.

"It's an important step because the changes to the law were very much things foreign companies were seeking," says John Sfakianakis, director of economic research at the Gulf Research Centre in Riyadh. "The new law brings Saudi closer to international standards."

Historically, non-Gulf investors located outside Saudi Arabia could only buy Riyadh-listed stocks through promissory notes or swaps, exposing buyers to counterparty risk and denying them voting rights. Only foreign investors living in Saudi could directly own Saudi stocks, as could Gulf nationals and institutions that were majority Gulf-owned.

From June 2015, Qualified Foreign Investors (QFIs) were allowed to trade Saudi stocks, but qualifying requirements and share ownership restrictions were so severe non-Saudi participation has been muted. A year later Saudis accounted for about 96% of the SAR84bn ($22.4bn) of shares traded on Riyadh's bourse. QFIs represented 0.1%.

"The changes to the law were very much things foreign companies were seeking"
JOHN SFAKIANIAKIS, GULF RESEARCH CENTRE

"The flow initially expected didn't materialise. The QFIs had concerns, particularly with regards to ownership limits and the minimum assets under management (AuM) required," says Asim Bukhtiar, head of research at Saudi Fransi Capital.

Relaxing restrictions

In May 2016, the Saudi Capital Markets Authority (CMA) announced it would ease restrictions in 2017; a foreign institution will be permitted to own up to 10% of a listed firm, doubling the current limit, although total foreign ownership in a particular company cannot exceed 49%.

Currently, institutions must have at least $5bn in AuM to become a QFI, but this will be slashed to $1bn, while other rules will be loosened so the likes of foreign sovereign wealth funds and university endowments can invest more easily.

"I welcome these changes. Saudi Arabia is a big market and we want to be able to invest there," says Jan Dehn, head of research at Ashmore Group, one of about a dozen QFIs.

"The more participants, the better the market will trade. It's equally important for global investors to get access to Saudi as valuations in developed economies look very stretched."

The CMA will abolish a rule whereby the holdings of all foreigners cannot exceed 10% of the total market. It will permit securities lending and covered short-selling, a move that may ease market volatility.

The settlement period for stock trades will be extended to two days (T+2). Currently, Saudi operates T+0, which is tricky for foreign investors, especially those in different time zones, with Saudi's Sunday to Thursday working week exacerbating the issue.

"T+0 has its challenges, not just in

terms of funding costs but also in control of assets, how the market settles and client protection. These are all issues that came up in our discussions with clients," says Kapil Seth, head of securities services for Middle East and North Africa at HSBC, another QFI. "In a T+0 market you need to have funds in your account for buy-side orders. Moving to T+2 enables DVP (delivery-versus-payment) and asset protection to be applied in a manner clients are comfortable with globally."

The reforms are a precursor to joining global indices such the MSCI Emerging Markets Index.

"The proposed changes should make the market more accessible to a broader spectrum of investors," says Seth. "It's about simplifying access and removing some of the ambiguities or challenges foreign investors had highlighted. The underlying theme is the authorities are listening to investors, which is promising."

The biggest ambiguity is that QFIs were limited in the number of shares they could own, but no such restrictions applied to foreigners buying shares via swaps or promissory notes. This inconsistency will be removed under the proposed rule changes.

In its June review, MSCI said the reforms would bring Saudi nearer to eligibility for emerging market status. "Market access will be a critical component of MSCI's decision, and these reforms enable Saudi to be eligible for EM index inclusion," says Asha Mehta, senior vice president and portfolio manager at Acadian Asset Management in Boston, which has $70bn of AuM and is in the midst of becoming a QFI. "The index provider could add Saudi to the EM index in a two to three year timeframe. This could be a material capital appreciation event for Saudi, as both passive and active capital rotate into the country."

Royal revolution

The market reforms tie into Prince Mohammed's stated aim of increasing direct foreign investment from SAR30bn to SAR70bn and create 450,000 private sector jobs by 2020.

"What Vision 2030 is trying to do is raise the brand awareness of Saudi Arabia," says Fransi's Bukhtiar. "One way to help do that is to get some of these large-cap companies to be recognised globally, namely through sizeable foreign ownership of their shares."

> **"The more participants, the better the market will trade. It's equally important for global investors to get access to Saudi Arabia"**
> JAN DEHN, ASHMORE GROUP

Reforming the stock market will also aid economic diversification. "By drawing upon a much broader range of investors, it's likely funding will become available for sectors other than those Saudi Arabian institutions have been attracted to," says Ashmore's Dehn.

In April, CMA chairman Mohammed Al-Jadaan told Bloomberg that Saudi will double the size of Riyadh's stock market by adding dozens of new listings and easing restrictions on foreign investors. He predicted the number of listed companies would rise to 250 from about 170 now, with Saudi also to introduce derivatives trading and real estate investment trusts as well as developing its debt market.

"It's useful for countries to have liquid bond markets, because this gives investors the option to keep their money in interest bearing securities during downturns in the business cycle instead of going into cash," says Dehn.

Opening up to foreign investors is part of the regulator's aim to increase institutional participation and thereby reduce volatility in a market where more than four-fifths of trading is done by individual investors, while foreign institutional investor participation could also spur companies to be more transparent and improve corporate governance.

"Disclosure levels in companies' quarterly earnings statements are very thin. Analysts and investors need more information," says Bukhtiar. "Things are improving – we have far greater management access than we did five or six years ago."

The CMA wants to broaden the bourse, for example to allow junior listings so that venture capital firms and start-ups can raise financing through the equity market. Bourse sectors will also be restructured to better align with international standards, for example creating a separate healthcare index.

"These changes are on an accelerated path so they're trying to introduce them by mid-2017," says Bukhtiar. "More announcements in this regard will be forthcoming this year. The urgency has increased."

Opening up

Madhur Bhandari, Head of Securities Services for HSBC Saudi Arabia Limited (HSBC SA) and Kapil Seth, Regional Head of HSBC Securities Services for Middle East and North Africa, HSBC Bank Middle East Limited (HBME), discuss access to Saudi Arabian capital markets

Can you summarise the current Qualified Foreign Investors regime (QFI) in Saudi Arabia (KSA) and any impending changes?

Madhur: Since last summer, the KSA has introduced – or announced – a number of capital market reforms designed to improve institutional participation, and thereby facilitate both foreign and domestic flows into the domestic stock market.

The biggest shift came in June 2015, when the KSA regulator the Capital Markets Authority (CMA) introduced the new QFI regime. Investors from outside the GCC had for some time enjoyed the economic benefits of access to KSA companies through synthetic products. But from June 2015, for the first time, the QFI regime has provided qualifying foreign investors full legal ownership of KSA stocks on the Tadawul, the KSA stock exchange.

The rules initially covered banks, broker-dealers, fund management companies and insurance companies with AuM of $5bn or more, which could show professional securities management experience of at least five years and were from a qualifying jurisdiction. Once they had been granted a QFI license, subject to ownership limits, they enjoyed the same legal ownership and voting rights as domestic investors.

Since then, the QFI regime has been expanded and the new Rules For Qualified Foreign Financial Institutions Investment in Listed Shares (the Rules) were introduced for public consultation, which ended in July 2016. The Rules have now been finalised and published and will be in force from 4 September 2016.

KSA market access has been made easier by relaxing the eligibility criteria, with greater access to more categories of investors and with enhanced ownership limits etc.

The AuM eligibility criteria of $5bn has been reduced to $1bn. Investment funds can now access the Saudi market directly as QFIs, as opposed to QFI clients in the earlier Rules. Having been limited to holding no more than 5% of any listed stock, a foreign investor may now own up to 10%. The overall limit of QFI ownership in a particular stock, which was 20%, has been removed, thereby providing foreign investors significant headroom within the overall foreign ownership cap – which is retained at 49% though some companies may have a different limit

Also, the CMA recently announced that QFIs will also be permitted to participate in IPOs of KSA companies for the first time. Further evidence of the regulators' policy of proactive engagement with investors has been the issuance of FAQ releases clarifying the Rules.

> **"The growing interest of foreign investors in KSA... is reflected in our business pipeline"**
> MADHUR BHANDARI

Given KSA's shifting economic model, what is the context for these reforms ?

Kapil: It's important to note that these rule changes affecting capital markets are not happening in a vacuum. They are part of a wider set of market changes that form a new vision for the development of capital markets in KSA.

Although many of the reforms pre-date the thinking contained in it, the wider strategy of the changes is contained in the KSA's Vision 2030, first detailed in April. This describes the proposed shift of the KSA's economic model away from oil, which will fuel new foreign investment and place it on a trajectory towards real economic diversification by 2030. For capital markets this vision includes the desire to shift the investor mix from the current heavy reliance on retail investors to one more weighted towards institutions.

The government appreciates that progress towards better corporate governance is important to appeal to institutional investors.

Changes have included measures to combat conflicts of interest among company board members and requirements covering the duration auditors can serve. Recently, the CMA mandated that the IFRS reporting framework be adopted for all KSA-listed companies from 2017. Local authorised persons, meanwhile, are now required to publish financial statements on their websites.

Furthermore, steps are being taken around increasing the investible universe. Vision 2030 talks of increasing the IPO pipeline with more state privatisations, in part by bringing a greater number of government companies to market. The most visible example is the public article in January 2016 of a possible listing of Saudi Aramco. Also notable are the plans announced by the Tadawul to list in 2018.

What associated changes are occurring to the KSA's market infrastructure?

Madhur: Critically, recent

announcements have tabled fundamental changes in the KSA's market infrastructure, notably around custody and settlement.

A proposed shift from the current T+0 settlement cycle to T+2 is one of the most notable examples. This introduces considerable relaxation of pre-funding and the associated costs of T+0 cycle. It is likely that the shift will go live in the first half of 2017. Given the size of the retail market , this is a considerable undertaking and it signals the commitment the regulator has towards client risk protection and facilitating greater alignment with institutional flows.

The second key shift in market infrastructure happened in 2015 around the introduction of an independent custody model (ICM), involving the segregation of investor assets from the brokers', allowing institutional investors to appoint a custodian independent from the broker and also trade with multiple brokers while keeping a single custodian. For the vast majority of local providers, brokerage and custody were considered the front and back end of the same model, so customers could not effectively segregate the custody of their assets from the firms they employed as broker-dealers.

HSBC SA has been providing independent custody to domestic and regional institutional participants for some time. Under the new ICM, similar formal adoption of segregation should become more prevalent.

As well as greater protection, a key benefit of segregation is flexibility. Firms will be able to use any licensed custodian purely as a custodian, for example, with no commitment to employ that entity as an executing broker.

How popular do you anticipate segregated custody will be?

Madhur: It is already popular with certain segments of domestic and regional institutional investors. With the entrance of QFIs, the increase in foreign investor participation is likely to further increase the uptake of segregated custody. In the case of KSA public funds, it is now mandatory to have independent custody arrangements. In the case of family offices and other institutional investors, we expect to see the increased need for a custodian. There are growth opportunities for custody and the wider securities services platform.

New rules governing investment funds provide a further pillar enshrining independent custody. Local public mutual fund managers, licensed by the CMA, must now appoint independent custodians for their existing and upcoming funds. Adopting international best practice introduces an additional layer of governance over the fund in addition to that exercised by the fund manager.

Phased implementation means that all existing funds must appoint an independent custodian by April 2018. The new amended Investment Funds Regulations will be in force from 6 November 2016 and our expectation is that all new investment funds launched after this will be required to appoint an independent custodian.

Together, these changes evidence the regulator's willingness to listen to market participants and implement best practices. The growing interest of foreign investors in KSA, partly due to these changes, is reflected in our business pipeline with the number of clients actively reviewing to join via QFI at multiples of the number that have been approved already.

"The government appreciates that progress towards better corporate governance is important to appeal to institutional investors"
KAPIL SETH

What is HSBC's role in widening of capital market access and how have your clients responded to the recent rule changes?

Kapil: Our role in this process is twofold. On the one hand, we funnel the views and sentiment of our investors around the world back to the KSA. On the other, we showcase the KSA story around our international network so that investors learn about the developments and are in a position to take advantage of them.

In both capacities, we have participated in the process of regulatory reform, helping realise the potential that these changes provide to our investors and contributing to the expansion of KSA capital markets.

HSBC Group's (HSBC) global presence in custody and clearing and HSBC SA's linkages with the wider group means we are in a good position to share our learning with the CMA. For our client network, we can disseminate the message quickly and clearly. HSBC's strong relationships with global custodians mean that we are in a position to educate them and their clients. We have also participated in several roadshows in various locations to educate clients about developments.

The related benefit for investors considering taking part in the KSA is the extent of the services we provide locally through HSBC SA. HSBC SA has the full suite of licenses from the CMA and is able to provide equity capital markets, equity trading and sales, research and custody. All of these separate businesses are subjected to our high standards of segregation and Chinese walls, but translating to an integrated and end-to-end solution for those who need it.

Our strength on the ground in the KSA has allowed us to move very quickly when changes have resonated with our clients. Our integrated efforts meant that HSBC Global Markets, in its own capacity, was one of the first to get a QFI license and trade on the opening day in June 2015. Another fund manager, a sizeable emerging market player, was also able to go live with its investments as a QFI shortly thereafter.

This two-pronged approach – relaying investors' sentiment to regulators and vice versa – is part of our best practice model when it comes to working in – and with – jurisdictions where similar capital markets expansion happening. It is similar to the role we played in markets including China in recent years and contributed to providing benefits to the local market as well for clients connecting to market opportunities.

Making waves

Supporting the kingdom's diversification agenda, a new shipping fund from a regional multilateral bank demonstrates how innovation is coming to the fore, writes *James Gavin*

While the proposed Aramco IPO has dominated the headlines *(see analysis, page 28)* it is far from the only ground-breaking Saudi initiative. Innovative funding solutions have been working their way into other parts of the Gulf kingdom's energy sector, adding capital market ballast to the government's long-term diversification ambitions as articulated by the Nation Transformation Programme released earlier in the year. Opportunities for banks, intermediaries and investors are sure to follow.

On 19 July, the Saudi-based pan-Arab multilateral development bank Apicorp announced the launch of the $1.5bn Apicorp Bahri Oil Shipping Fund. Framed as an attractive investment opportunity for large and sophisticated local and regional investors it also, crucially, seeks to support economic diversification by creating a bulk shipping giant (although focused on oil transportation).

The closed-end fund, launched in association with the state-owned National Shipping Company of Saudi Arabia (Bahri), will target the acquisition of approximately 15 very large crude carriers (VLCCs) over three phases with total investments of up to $1.5bn composed of debt and equity. It will have a 10-year life period and deliver returns derived from the commercial employment of the VLCCs.

Apicorp will be the main investor and fund manager, while Bahri will serve as the exclusive commercial and technical manager. The bank will cover 85% of the investment in the fund with Bahri investing the remaining 15%. Essentially, Apicorp and Bahri will be the anchor or seed investors, which will subsequently sell down to a wider pool of investors.

This venture into maritime funds is not a step into the unknown for Apicorp. The bank, which has made equity investments worth $13bn, launched its first such fund, the $150m Apicorp Petroleum Shipping Fund, in early 2013. That five-year closed-end fund achieves returns by leveraging growth opportunities in the petroleum products tanker charter market and is co-managed by Tufton Oceanic, a global fund manager in the maritime and energy-related industries.

That earlier fund's success provided the grounding for Apicorp's launch of the new fund. The link with Bahri, whose mandate is to transport Aramco's crude oil, is significant. According to Ibrahim al-Omar, CEO of Bahri, the company's current fleet extends to 36 VLCCs and ten new build orders scheduled for delivery in 2017-18. The 15 crude carriers proposed for acquisition under this fund would, he said, "propel Bahri into becoming the largest operator of VLCCs in the world."

Strategic significance

Apicorp and Bahri's investment is strategically important to the kingdom and other Arab oil exporting countries as it materially increases the locally and regionally-controlled capacity for crude transport, says Bennie Burger, executive vice president and acting head of investments at Apicorp.

Observers see a broader regional trend going beyond Saudi borders that new fund innovations are helping develop. "Important developments are happening in the fund management industry in the region," says M R Raghu, head of research at Kuwait-based investment house Markaz, who points out those high-profile recruitments are also being made to increase the amount of assets that is being managed internally.

"Amid a lower oil price environment, sovereign wealth funds in the Gulf region are overhauling their structures and processes in a bid to make them agile and more accountable. For instance, to realise economies of scale and subsequently contain costs, the UAE merged its IPIC and Mubadala funds."

The new Apicorp fund, says Burger, provides an opportunity for the bank to reinforce its ability to structure large and complex financial transactions.

With 17% of its shares owned by the Saudi government (the remainder being accounted for by other Arab oil producing states) its remit is to support

"The 15 crude carriers proposed for acquisition would propel Bahri into becoming the largest operator of VLCCs in the world"
IBRAHIM AL-OMAR, BAHRI

the growth and development of the energy and related sectors in its member countries and the broader Arab region.

Discussions between the two firms resulted in a realisation that the problem that Bahri was looking to solve created an opportunity for Apicorp to develop an aspect of its business that would be of interest to strategic investors.

"From a strategic perspective it is important to have control over your ability to export and transport crude oil. We were facing a situation where the available capacity for the transportation of crude was not sufficient to cover for the demand for Saudi Arabian oil. With the creation of this new fund there was an opportunity to do exactly this," says Burger.

Above all, the bank believes the shipping fund could offer some potentially very attractive returns for investors. According to Burger, Bahri has a stellar track record as VLCC fleet owner and manager. "Bahri's enviable status as national shipping company to Saudi Arabia provides the fund with some significant sustainable competitive advantages, which underpins our positive outlook," he says.

The funds themselves have been structured into three digestible chunks worth around $500m each, thereby avoiding exposure to execution risk that a $1.5bn fund might involve.

Reaching out to investors

There will be a limited sell down of a portion of the equity in each stage. It is anticipated that the sell down will be targeted at selected large, sophisticated and strategic investors, whose interests are aligned with the founders of the fund.

The fund fits with a broader evolution of Apicorp's business model in which it is actively growing its various business lines as well as product and service ranges, including its equity investment franchise.

Burger points out that the bank would be keen to work with strategic partners in the establishment of similar funding vehicles, especially if it supports the growth and development of the energy or energy-related sectors. It is also highly likely that this fund will assist Apicorp and Bahri in playing a role in the further growth and development of Islamic capital markets.

Apicorp is in discussions with a wide range of existing and potential new strategic partners, including a global investment manager. "We believe in working with like-minded professionals who are experts in their field," says Burger. "A good partner will assist you in avoiding the potential pitfalls of investing in their areas of expertise, whether that is a specific industry, sector or geography. It would be very arrogant of us to think we have all the answers to all the questions."

The partnership approach can be illustrated in fairly recent investments that Apicorp has made with Fajr and Waha Capital in National Petroleum Services and Fajr and Jadwa, a Riyadh based asset manager, in Saudi Mechanical Industries. It has also in the recent past committed to investment funds in partnerships with the International Finance Corporation and ACWA, a Saudi power company, both for infrastructural development purposes in the region.

"One of the big spin-off benefits in creating a bigger investment franchise was also that it enabled us to create a fund that provided an investment opportunity for large, sophisticated local investors. It is known that we have a number of large pension funds and asset managers in the region and that there is a scarcity of available quality local assets to invest in, especially income-generating investments. This creates an attractive investment vehicle for them," says Burger.

The government agenda, driven by the ambitious young deputy crown prince Mohammed Bin Salman, is heavily focused on ending the state's dominance of the economy so new fund instruments will play an important role in promoting diversification away from oil. The marriage of the kingdom's oil export prowess to capital market instruments may well emerge as a significant investment theme.

EMERGING MARKETS: APPOINTMENTS

Russia's CSD, the **National Settlement Depository**, has made a trio of director-level appointments, adding **Artyom Duvanov**, **Denis Buryakov** and **Tatiana Trostyanitskaya** to its team. Duvanov will be responsible for researching, planning and implementing plans related to innovation issues. Buryakov will focus on developing the NSD's depository services and promoting those services in both the Russian and international markets.

Old Mutual Global Investors has appointed **Richard Mo** to the newly created position of head of China. Mo will report to Carol Wong, the firm's managing director, Asia Pacific. He will be responsible for developing relationships with regulators, global financial institutions and distributors in the region, with a focus on China, said a London-based spokeswoman for the firm. Mo left his previous role as head of China retail business with JPMorgan Asset Management at the start of the year.

Stephen Deane has joined **Henderson Global Investors** from Stewart Investors (previously known as First State Stewart) as a senior portfolio manager. He will work alongside the head of emerging markets equities, Glen Finegan, and the wider emerging markets equities team. Stephen will be based in Henderson's Edinburgh office.

JPMorgan Asset Management has appointed **Rossano Nonino** chief investment officer and head of real estate, Brazil. Nonino, who founded Gávea Real Estate in 2012, will work out of the São Paolo office, leading a team of eight investment professionals.

Moscow Exchange has named **Anna Kuznetsova** and **Igor Marich** as members of its executive board. Both Kuznetsova and Marich, who oversee the firm's equity, bond, FX and money markets units respectively, have been appointed on two year terms. Six members now make up the Russian bourse's board including chief executive Alexander Afanasiev and chief finance officer Evgeny Fetisov.

Quantum Global Group, the Africa-focused investment firm, has appointed **David Mauro Figueiredo de Carvalho** as regional director for Angola and Mozambique. The hire comes as the group continues to diversify its portfolio of investments and attract foreign investments across key African markets.

Northstar Financial Services has opened an office in Dubai office and appointed **Sanjeev Chowdhury** as principal representative. The office has been established to support financial advisors distributing the firm's international investment solutions across the Middle East and Africa. Chowdhury previously played a key role in building Sun Life International's presence in the Middle East, having prior to that worked in the Dubai branches of Standard Chartered and ABN Amro.

BNP Paribas Investment Partners announces the appointment of **Jean-Charles Sambor** as deputy head of emerging market fixed income. He is based in London and reports to L Bryan Carter, head of emerging market fixed income.

EFG Asset Management has appointed of **Rebekah Chuan** as CEO and head of investments of EFGAM Singapore as part of the firm's ongoing development in Asia. Chuan will lead and drive the business regionally and will have executive responsibility for developing the investment solutions offering. Previously, she was head of discretionary at HSBC (Suisse) Private Bank based in Singapore for 10 years and, prior to that, she held senior roles at Newton Investment Management, AXA Asset Management and Aviva Investors

Mitsubishi UFJ Financial Group has hired **Harvey Colli** as a managing director to oversee its transaction banking business in Latin America. Colli, who assumes the new role after 15 years in senior positions with JPMorgan and Citi, will focus on Latin American and Japanese corporate clients. Based in São Paulo, he reports to Junsuke (John) Koike, MUFG's regional head for Latin America.

BCS Global Markets, a securities broker on the Moscow Exchange, has made five senior hires in its investment banking services team to drive the expansion of the group. **Igor Ushakov**, managing director, will run BCS Global Markets' mining and metallurgical division. **Azer Mamedov** will head up consumer, TMT, retail sales and real estate. **Aleksey Kletenkov**, director, will be in charge of operations for equity capital markets. **Dmitry Kozyrev** is to lead the the oil and gas, petro-chemistry and chemistry division. **Oleg Zubarev** will be in charge of financial services and joins with seven years of experience in investment banking, having worked for both Morgan Stanley and Nomura.

PIMCO has hired **Gene Frieda** as executive vice president and global strategist for the firm's emerging markets and global strategies and Yacov Arnopolin as executive vice president and emerging markets portfolio manager. They will both be based in London. Frieda, who will work primarily with the emerging markets team but will also contribute to other global, country and sector strategies, will report to Andrew Balls, managing director and chief investment officer – global fixed income. Arnopolin, who will focus primarily on emerging markets external debt strategies, will report to Michael Gomez, managing director and head of the emerging markets portfolio management team.

UBS Asset Management has appointed **Hayden Briscoe** as head of fixed income, Asia Pacific. He joins from Alliance Bernstein, and brings more than 24 years of fixed income and currency experience. In this new role, based in Hong Kong, he will oversee all fixed income portfolio management and business activities in the region. Briscoe reports to John Dugenske, global head of fixed income, UBS Asset Management, and is part of the asset management APAC executive committee.


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